

ENCORE CAPITAL GROUP INC

Form 10-Q

August 08, 2018

Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

---

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2018

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 48-1090909

(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification No.)

3111 Camino Del Rio North, Suite 103 92108  
San Diego, California

(Address of principal executive offices) (Zip code)

(877) 445 - 4581

(Registrant's telephone number, including area code)

(Not Applicable)

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

---

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the last 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer   
Accelerated filer  Non-accelerated filer  Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

Edgar Filing: ENCORE CAPITAL GROUP INC - Form 10-Q

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 August 1, 2018
Common Stock, \$0.01 par value	30,837,746 shares

---

Table of Contents

ENCORE CAPITAL GROUP, INC.  
INDEX TO FORM 10-Q

	Page
<u>PART I – FINANCIAL INFORMATION</u>	<u>3</u>
<u>Item 1—Condensed Consolidated Financial Statements (Unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Statements of Financial Condition</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
<u>Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>31</u>
<u>Item 3 – Quantitative and Qualitative Disclosures About Market Risk</u>	<u>61</u>
<u>Item 4 – Controls and Procedures</u>	<u>61</u>
<u>PART II – OTHER INFORMATION</u>	<u>62</u>
<u>Item 1 – Legal Proceedings</u>	<u>62</u>
<u>Item 1A – Risk Factors</u>	<u>62</u>
<u>Item 6 – Exhibits</u>	<u>62</u>
<u>SIGNATURES</u>	<u>63</u>

---

Table of Contents

## PART I – FINANCIAL INFORMATION

## Item 1—Condensed Consolidated Financial Statements (Unaudited)

## ENCORE CAPITAL GROUP, INC.

## Condensed Consolidated Statements of Financial Condition

(In Thousands, Except Par Value Amounts)

(Unaudited)

	June 30, 2018	December 31, 2017
Assets		
Cash and cash equivalents	\$ 181,657	\$ 212,139
Investment in receivable portfolios, net	3,084,621	2,890,613
Deferred court costs, net	90,872	79,963
Property and equipment, net	89,071	76,276
Other assets	250,923	302,728
Goodwill	909,063	928,993
Total assets	\$4,606,207	\$4,490,712
Liabilities and Equity		
Liabilities:		
Accounts payable and accrued liabilities	\$ 286,386	\$ 284,774
Debt, net	3,530,415	3,446,876
Other liabilities	37,732	35,151
Total liabilities	3,854,533	3,766,801
Commitments and contingencies		
Redeemable noncontrolling interest	136,188	151,978
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, 25,931 shares and 25,801 shares issued and outstanding as of June 30, 2018 and December 31, 2017, respectively	259	258
Additional paid-in capital	68,820	42,646
Accumulated earnings	652,428	616,314
Accumulated other comprehensive loss	(96,900 )	(77,356 )
Total Encore Capital Group, Inc. stockholders' equity	624,607	581,862
Noncontrolling interest	(9,121 )	(9,929 )
Total equity	615,486	571,933
Total liabilities, redeemable equity and equity	\$4,606,207	\$4,490,712

The following table includes assets that can only be used to settle the liabilities of the Company's consolidated variable interest entities ("VIEs") and the creditors of the VIEs have no recourse to the Company. These assets and liabilities are included in the consolidated statements of financial condition above. See Note 9, "Variable Interest Entities" for additional information on the Company's VIEs.

	June 30, 2018	December 31, 2017
Assets		
Cash and cash equivalents	\$ 79,732	\$ 88,902
Investment in receivable portfolios, net	1,438,379	1,342,300
Deferred court costs, net	29,164	26,482
Property and equipment, net	22,152	23,138
Other assets	119,254	122,263
Goodwill	705,381	724,054

Liabilities

Accounts payable and accrued liabilities	\$ 137,308	\$ 151,208
Debt, net	2,055,766	2,014,202
Other liabilities	—	1,494

See accompanying notes to condensed consolidated financial statements

3

---

Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues				
Revenue from receivable portfolios	\$292,662	\$263,407	\$573,671	\$513,245
Other revenues	39,453	18,681	75,421	38,652
Total revenues	332,115	282,088	649,092	551,897
Allowance reversals on receivable portfolios, net	17,632	8,829	27,443	10,961
Total revenues, adjusted by net allowances	349,747	290,917	676,535	562,858
Operating expenses				
Salaries and employee benefits	90,960	75,786	180,219	144,064
Cost of legal collections	51,255	53,409	105,110	101,366
Other operating expenses	39,039	24,030	72,787	50,390
Collection agency commissions	12,151	11,494	23,905	23,056
General and administrative expenses	41,986	36,932	81,270	70,250
Depreciation and amortization	10,923	8,672	21,359	17,297
Total operating expenses	246,314	210,323	484,650	406,423
Income from operations	103,433	80,594	191,885	156,435
Other (expense) income				
Interest expense	(60,536 )	(50,516 )	(117,998 )	(99,714 )
Other (expense) income	(4,615 )	2,529	(2,422 )	3,131
Total other expense	(65,151 )	(47,987 )	(120,420 )	(96,583 )
Income from continuing operations before income taxes	38,282	32,607	71,465	59,852
Provision for income taxes	(11,308 )	(13,531 )	(20,778 )	(25,598 )
Income from continuing operations	26,974	19,076	50,687	34,254
Loss from discontinued operations, net of tax	—	—	—	(199 )
Net income	26,974	19,076	50,687	34,055
Net (income) loss attributable to noncontrolling interest	(676 )	1,179	(2,562 )	8,298
Net income attributable to Encore Capital Group, Inc. stockholders	\$26,298	\$20,255	\$48,125	\$42,353
Amounts attributable to Encore Capital Group, Inc.:				
Income from continuing operations	\$26,298	\$20,255	\$48,125	\$42,552
Loss from discontinued operations, net of tax	—	—	—	(199 )
Net income	\$26,298	\$20,255	\$48,125	\$42,353
Earnings (loss) per share attributable to Encore Capital Group, Inc.:				
Basic earnings (loss) per share from:				
Continuing operations	\$1.01	\$0.78	\$1.84	\$1.64
Discontinued operations	\$—	\$—	\$—	\$(0.01 )
Net basic earnings per share	\$1.01	\$0.78	\$1.84	\$1.63
Diluted earnings (loss) per share from:				
Continuing operations	\$1.00	\$0.77	\$1.82	\$1.62
Discontinued operations	\$—	\$—	\$—	\$(0.01 )
Net diluted earnings per share	\$1.00	\$0.77	\$1.82	\$1.61

Weighted average shares outstanding:

Edgar Filing: ENCORE CAPITAL GROUP INC - Form 10-Q

Basic	26,150	25,983	26,103	25,930
Diluted	26,409	26,391	26,413	26,240

See accompanying notes to condensed consolidated financial statements

Table of Contents

## ENCORE CAPITAL GROUP, INC.

Condensed Consolidated Statements of Comprehensive (Loss) Income  
(Unaudited, In Thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$26,974	\$19,076	\$50,687	\$34,055
Other comprehensive (loss) income, net of tax:				
Change in unrealized gains/losses on derivative instruments:				
Unrealized (loss) gain on derivative instruments	(1,485 )	963	(2,154 )	1,434
Income tax effect	699	35	539	(512 )
Unrealized (loss) gain on derivative instruments, net of tax	(786 )	998	(1,615 )	922
Change in foreign currency translation:				
Unrealized (loss) gain on foreign currency translation	(35,022 )	7,824	(16,517 )	22,288
Other comprehensive (loss) income, net of tax	(35,808 )	8,822	(18,132 )	23,210
Comprehensive (loss) income	(8,834 )	27,898	32,555	57,265
Comprehensive (income) loss attributable to noncontrolling interest:				
Net (income) loss	(676 )	1,179	(2,562 )	8,298
Unrealized loss (gain) on foreign currency translation	371	1,841	(1,412 )	(1,409 )
Comprehensive (income) loss attributable to noncontrolling interest	(305 )	3,020	(3,974 )	6,889
Comprehensive (loss) income attributable to Encore Capital Group, Inc. stockholders	\$(9,139 )	\$30,918	\$28,581	\$64,154
See accompanying notes to condensed consolidated financial statements				



Table of Contents

## ENCORE CAPITAL GROUP, INC.

## Condensed Consolidated Statements of Cash Flows

(Unaudited, In Thousands)

	Six Months Ended	
	June 30,	
	2018	2017
Operating activities:		
Net income	\$ 50,687	\$ 34,055
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss from discontinued operations, net of income taxes	—	199
Depreciation and amortization	21,359	17,297
Other non-cash expense, net	14,797	21,309
Stock-based compensation expense	5,445	3,510
Loss (gain) on derivative instruments, net	8,656	(2,623)
Deferred income taxes	8,256	(3,164)
Allowance reversals on receivable portfolios, net	(27,443)	(10,961)
Changes in operating assets and liabilities		
Deferred court costs and other assets	(13,366)	(5,951)
Prepaid income tax and income taxes payable	22,550	20,389
Accounts payable, accrued liabilities and other liabilities	6,686	(2,770)
Net cash provided by operating activities	97,627	71,290
Investing activities:		
Cash paid for acquisitions, net of cash acquired	—	(5,623)
Purchases of receivable portfolios, net of put-backs	(633,040)	(464,507)
	415,174	371,285

Collections applied to investment in receivable portfolios, net				
Purchases of property and equipment	(24,655	)	(11,984	)
Payments to acquire interest in affiliates	—		(8,805	)
Other, net	1,634		4,559	
Net cash used in investing activities	(240,887	)	(115,075	)
Financing activities:				
Payment of loan costs	(1,387	)	(3,415	)
Proceeds from credit facilities	425,650		331,020	
Repayment of credit facilities	(292,430	)	(373,345	)
Repayment of senior secured notes	(1,029	)	(6,174	)
Proceeds from issuance of convertible— senior notes			150,000	
Repayment of convertible senior notes	—		(60,406	)
Proceeds from convertible hedge instruments	—		5,580	
Taxes paid related to net share settlement of equity awards	(2,651	)	(2,457	)
Other, net	(7,118	)	(4,954	)
Net cash provided by financing activities	121,035		35,849	
Net decrease in cash and cash equivalents	(22,225	)	(7,936	)
Effect of exchange rate changes on cash and cash equivalents	(8,257	)	4,818	
Cash and cash equivalents, beginning of period	212,139		149,765	
Cash and cash equivalents, end of period	\$ 181,657		\$ 146,647	

See accompanying notes to condensed consolidated financial statements

Table of Contents

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 with Encore, the “Company”), is an international specialty finance company providing debt recovery solutions and other related services for consumers across a broad range of financial assets. The Company purchases portfolios of defaulted consumer receivables at deep discounts to face value and manages them by working with individuals as they repay their obligations and work toward financial recovery. Defaulted receivables are consumers’ unpaid financial commitments to credit originators, including banks, credit unions, consumer finance companies, commercial retailers, and telecommunication companies. Defaulted receivables may also include receivables subject to bankruptcy proceedings.

The Company is a market leader in portfolio purchasing and recovery in the United States, including Puerto Rico. Cabot Credit Management plc (together with its subsidiaries, “Cabot”), the Company’s largest international subsidiary, is one of the largest credit management services providers in Europe and is a market leader in the United Kingdom and Ireland. Previously, Encore controlled Cabot via its majority ownership interest in the indirect holding company of Cabot, Janus Holdings S.a r.l. (“Janus Holdings”). On July 24, 2018, the Company completed the purchase of all of the outstanding equity of Cabot not owned by the Company (the “Cabot Transaction”). As a result, Cabot became a wholly owned subsidiary of Encore. These are the Company’s primary operations.

Financial Statement Preparation and Presentation

The accompanying interim condensed consolidated financial statements have been prepared by the Company, without audit, in accordance with the instructions to the Quarterly Report on Form 10-Q, and Rule 10-01 of Regulation S-X promulgated by the United States Securities and Exchange Commission (the “SEC”) 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 (“GAAP”).

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 financial position, results of operations, 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, 2017. 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 GAAP 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.

Basis of Consolidation

The condensed consolidated financial statements have been prepared in conformity with GAAP, and reflect the accounts and operations of the Company and those of its subsidiaries in which the Company has a controlling financial interest. The Company also consolidates VIEs, for which it is the primary beneficiary. The primary beneficiary has both (a) the power to direct the activities of the VIE that most significantly affect the entity’s economic performance, and (b) either the obligation to absorb losses or the right to receive benefits. Refer to Note 9, “Variable Interest Entities,” for further details. All intercompany transactions and balances have been eliminated in consolidation.

Translation of Foreign Currencies

The financial statements of certain of the Company’s foreign subsidiaries are measured using their local currency as the functional currency. Assets and liabilities of foreign operations are translated into U.S. dollars using period-end exchange rates, and revenues and expenses are translated into U.S. dollars using average exchange rates in effect during each period. The resulting translation adjustments are recorded as a component of other comprehensive income or loss. Equity accounts are translated at historical rates, except for the change in retained earnings during the year which is the result of the income statement translation process. Intercompany transaction gains or losses at each period end arising from subsequent measurement of balances for which settlement is not planned or anticipated in the foreseeable future are included as translation adjustments and recorded within other comprehensive income or loss. Translation gains or losses are the material components of accumulated other comprehensive income or loss.

Transaction gains and losses are included in other income or expense.

7

---

## Table of Contents

### Reclassifications

Certain immaterial reclassifications have been made to the condensed consolidated financial statements to conform to the current year's presentation.

### Change in Accounting Principle

In May 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers ("Topic 606" or "ASU 2014-09"). The objective of ASU 2014-09 is to establish a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. ASU 2014-09 supersedes most of the existing revenue recognition guidance, including industry-specific guidance. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 applies to all contracts with customers except those that are within the scope of other topics in the FASB's Accounting Standards Codification ("ASC"). Under the prior accounting standard, the Company recognized revenue when there was persuasive evidence of an arrangement, the sales price was fixed or determinable, the services had been performed and collectability was reasonably assured.

The Company's investment in receivable portfolios is outside of the scope of Topic 606 since it is accounted for in accordance with ASC 310-30. Certain of the Company's international subsidiaries earn fee-based income by providing portfolio management services to credit originators for non-performing loans. Performance obligations for this revenue stream under the new standard primarily arise from debt collection and management activities. These performance obligations are typically satisfied when services are performed, or debt is collected. Consideration is typically variable based on indeterminate volumes or collection activity. Under the new accounting standard, revenue is recognized over time as a series of single performance obligations when the Company is entitled to a percentage of collections received, since the customer simultaneously receives and consumes the benefits provided by the Company's performance of debt collection and management. The method for measuring progress towards satisfying a performance obligation is based on transaction volumes or debt collected, depending on whether the contract is based on services performed or based on commissions. Costs to fulfill a contract are expensed when incurred.

The Company adopted the requirements of Topic 606 as of January 1, 2018, utilizing the modified retrospective method of transition and elected to apply the revenue standard only to contracts that were not completed as of the adoption date. Prior periods were not restated. The cumulative effect of adopting this new standard had no impact to retained earnings. The impact of adopting Topic 606 on the Company's revenue is not material to any of the periods presented. Fee-based income is included in "Other Revenues" in the Company's consolidated statements of operations.

In August 2017, the FASB issued ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities—Derivatives and Hedging ("Topic 815" or "ASU 2017-12") which amends the hedge accounting recognition and presentation requirements in ASC 815. ASU 2017-12 improves Topic 815 by simplifying and expanding the eligible hedging strategies for financial and nonfinancial risks by more closely aligning hedge accounting with a company's risk management activities, and also simplifies its application through targeted improvements in key practice areas. This includes expanding the list of items eligible to be hedged and amending the methods used to measure the effectiveness of hedging relationships. In addition, ASU 2017-12 prescribes how hedging results should be presented and requires incremental disclosures. These changes are intended to allow preparers more flexibility and to enhance the transparency of how hedging results are presented and disclosed. Further, the new standard provides partial relief on the timing of certain aspects of hedge documentation and eliminates the requirement to recognize hedge ineffectiveness separately in earnings in the current period. For public entities, ASU 2017-12 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted in any interim period or fiscal year. The Company early adopted ASU 2017-12 as of the second quarter of 2018 retroactive to January 1, 2018. The adoption of the new standard did not have a material effect on the Company's financial position, results of operations, or required presentations.

### Recent Accounting Pronouncements

Other than the adoption of the standards discussed above, there have been no new accounting pronouncements made effective during the three and six months ended June 30, 2018 that have significance, or potential significance, to the Company's consolidated financial statements.

Recent Accounting Pronouncements Not Yet Effective

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350). The amendments in this update simplify the test for goodwill impairment by eliminating Step 2 from the impairment test, which required the entity to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities following the procedure

8

---

Table of Contents

that would be required in determining fair value of assets acquired and liabilities assumed in a business combination. The amendments in this update are effective for public companies for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company did not early adopt this guidance for its annual goodwill impairment testing.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”). ASU 2016-13 applies a current expected credit loss model which is a new impairment model based on expected losses rather than incurred losses. Under this model, an entity would recognize an impairment allowance equal to its current estimate of all contractual cash flows that the entity does not expect to collect from financial assets measured at amortized cost. The estimate of expected credit losses should consider historical information, current information, as well as reasonable and supportable forecasts, including estimates of prepayments. The expected credit losses, and subsequent adjustments to such losses, will be recorded through an allowance account that is deducted from the amortized cost basis of the financial asset, with the net carrying value of the financial asset presented on the consolidated balance sheet at the amount expected to be collected. ASU 2016-13 eliminates the current accounting model for loans and debt securities acquired with deteriorated credit quality under ASC 310-30, which provides authoritative guidance for the accounting of the Company’s investment in receivable portfolios. Under this new standard, entities will gross up the initial amortized cost for the purchased financial assets with credit deterioration (“PCD assets”), the initial amortized cost will be the sum of (1) the purchase price and (2) the estimate of credit losses as of the date of acquisition. After initial recognition of PCD assets and the related allowance, any change in estimated cash flows (favorable or unfavorable) will be immediately recognized in the income statement because the yield on PCD assets would be locked. ASU 2016-13 is effective for reporting periods beginning after December 15, 2019 with early adoption permitted for reporting periods beginning after December 15, 2018. The guidance will be applied on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period in which ASU 2016-13 is adopted. However, the FASB has determined that financial assets for which the guidance in Subtopic 310-30, Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality, has previously been applied should prospectively apply the guidance in ASU 2016-13 for PCD assets. A prospective transition approach should be used for PCD assets where upon adoption, the amortized cost basis should be adjusted to reflect the addition of the allowance for credit losses. This transition relief will avoid the need for a reporting entity to reassess its purchased financial assets that exist as of the date of adoption to determine whether they would have met at acquisition the new criteria of more-than insignificant credit deterioration since origination. The transition relief also will allow an entity to accrete the remaining noncredit discount (based on the revised amortized cost basis) into interest income at the effective interest rate at the adoption date of ASU 2016-13. The same transition requirements should be applied to beneficial interests that previously applied Subtopic 310-30 or have a significant difference between contractual cash flows and expected cash flows. The Company is in the process of determining the effects the adoption will have on its consolidated financial statements as well as whether to adopt the new guidance early. The Company has established a project management team and is in the process of developing its accounting policy, evaluating the impact of this pronouncement and researching software resources that could assist with the implementation.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 changes accounting for leases and requires lessees to recognize the assets and liabilities arising from most leases, including those classified as operating leases under previous accounting guidance, on the balance sheet and requires disclosure of key information about leasing arrangements to increase transparency and comparability among organizations. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, which provides narrow amendments to clarify how to apply certain aspects of the new lease standard. The new guidance must be adopted using the modified retrospective approach and will be effective for the Company starting in the first quarter of fiscal year 2019. Early adoption is permitted; however, the Company does not intend to early adopt ASU 2016-02 and ASU 2018-10. The Company is developing an inventory of all leases, accumulating the lease data necessary to apply the amended guidance and is in the process of determining the effects the adoption will have on its consolidated financial statements, systems and processes. The Company has selected a software to assist with implementation to the

standard.

With the exception of the updated standards discussed above, there have been no new accounting pronouncements not yet effective that have significance, or potential significance, to the Company's consolidated financial statements.

9

---



Table of Contents

## Note 2: Earnings Per Share

Basic earnings or loss per share is calculated by dividing net earnings or loss attributable to Encore by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is calculated on the basis of the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options, restricted stock, and the dilutive effect of the convertible senior notes, if applicable.

A reconciliation of shares used in calculating earnings per basic and diluted shares follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Weighted average common shares outstanding—basic	26,150	25,983	26,103	25,930
Dilutive effect of stock-based awards	259	160	310	186
Dilutive effect of convertible senior notes	—	248	—	124
Weighted average common shares outstanding—diluted	26,409	26,391	26,413	26,240

Anti-dilutive employee stock options outstanding were approximately 13,000 during each of the three and six months ended June 30, 2018. Anti-dilutive employee stock options outstanding were approximately 317,000 and 200,000 during the three and six months ended June 30, 2017, respectively.

## Note 3: Fair Value Measurements

The authoritative guidance for fair value measurements defines fair value as the price that would be received upon sale of an asset or the price paid to transfer a liability, in an orderly transaction between market participants at the measurement date (i.e., the “exit price”). The guidance utilizes a fair value hierarchy that prioritizes the inputs used in valuation techniques to measure fair value into three broad levels. The following is a brief description of each level:

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

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

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

## Financial Instruments Required To Be Carried At Fair Value

Financial assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

	Fair Value Measurements as of June 30, 2018			
	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Foreign currency exchange contracts	\$—	\$1,035	\$—	\$1,035
Interest rate swap agreements	—	10	—	10
Interest rate cap contracts	—	2,191	—	2,191
<b>Liabilities</b>				
Foreign currency exchange contracts	—	(7,211)	—	(7,211)
Contingent consideration	—	—	(6,993)	(6,993)
<b>Temporary Equity</b>				
Redeemable noncontrolling interest	—	—	(136,188)	(136,188)

Table of Contents

	Fair Value Measurements as of December 31, 2017			
	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Foreign currency exchange contracts	\$—	\$1,912	\$—	\$1,912
Interest rate cap contracts	—	3,922	—	3,922
<b>Liabilities</b>				
Foreign currency exchange contracts	—	(1,110 )	—	(1,110 )
Interest rate swap agreements	—	(7 )	—	(7 )
Contingent consideration	—	—	(10,612)	(10,612)
<b>Temporary Equity</b>				
Redeemable noncontrolling interest	—	—	(151,978)	(151,978)

**Derivative Contracts:**

The Company uses derivative instruments to manage its exposure to fluctuations in interest rates and foreign currency exchange rates. Fair values of these derivative instruments are estimated using industry standard valuation models. These models project future cash flows and discount the future amounts to a present value using market-based observable inputs, including interest rate curves, foreign currency exchange rates, and forward and spot prices for currencies.

**Contingent Consideration:**

The Company carries certain contingent liabilities resulting from its mergers and acquisition activities. Certain sellers of the Company's acquired entities could earn additional earn-out payments in cash based on the entities' subsequent operating performance. The Company recorded the acquisition date fair values of these contingent liabilities, based on the likelihood of contingent earn-out payments, as part of the consideration transferred. The earn-out payments are subsequently remeasured to fair value at each reporting date. The Company reviewed the earn-out analysis for the three and six months ended June 30, 2018 and determined that, based on actual and forecasted operating performance, the expected future earn-out payments would be reduced by approximately \$2.4 million and \$4.7 million, respectively. As of June 30, 2018, the aggregated fair value of the contingent consideration was approximately \$7.0 million. The following table provides a roll forward of the fair value of contingent consideration for the periods ended June 30, 2018 and December 31, 2017 (in thousands):

	Amount
Balance at December 31, 2016	\$2,531
Issuance of contingent consideration in connection with acquisition	10,808
Change in fair value of contingent consideration	(2,465 )
Payment of contingent consideration	(781 )
Effect of foreign currency translation	519
Balance at December 31, 2017	10,612
Issuance of contingent consideration in connection with acquisition	1,728
Change in fair value of contingent consideration	(4,652 )
Payment of contingent consideration	(232 )
Effect of foreign currency translation	(463 )
Balance at June 30, 2018	\$6,993

**Redeemable Noncontrolling Interest:**

Some minority shareholders in certain subsidiaries of the Company have the right, at certain times, to require the Company to acquire their ownership interest in those entities at fair value and, in some cases, to force a sale of the subsidiary if the Company chooses not to purchase their interests at fair value. The noncontrolling interest subject to these arrangements is included in temporary equity as redeemable noncontrolling interest, and is adjusted to its estimated redemption amount each reporting period with a corresponding adjustment to additional paid-in capital. Future reductions in the carrying amount are subject to a "floor" amount that is equal to the fair value of the redeemable

noncontrolling interest at the time it was originally recorded. The recorded value of the redeemable noncontrolling interest cannot go below the floor level. Adjustments to the

11

---

Table of Contents

carrying amount of redeemable noncontrolling interest are charged to retained earnings (or to additional paid-in capital if there are no retained earnings) and do not affect net income or comprehensive income in the consolidated financial statements.

The components of the change in the redeemable noncontrolling interest for the periods ended June 30, 2018 and December 31, 2017 are presented in the following table (in thousands):

	Amount
Balance at December 31, 2016	\$45,755
Addition to redeemable noncontrolling interest	277
Net loss attributable to redeemable noncontrolling interest	(4,905 )
Adjustment of the redeemable noncontrolling interest to fair value	108,296
Effect of foreign currency translation attributable to redeemable noncontrolling interest	2,555
Balance at December 31, 2017	151,978
Redemption of redeemable noncontrolling interest	(11,536 )
Net income attributable to redeemable noncontrolling interest	2,373
Adjustment of the redeemable noncontrolling interest to fair value	(7,419 )
Effect of foreign currency translation attributable to redeemable noncontrolling interest	792
Balance at June 30, 2018	\$136,188

**Financial Instruments Not Required To Be Carried At Fair Value****Investment in Receivable Portfolios:**

The Company records its investment in receivable portfolios at cost, which represents a significant discount from the contractual receivable balances due. The Company computes the fair value of its investment in receivable portfolios using Level 3 inputs by discounting the estimated future cash flows generated by its proprietary forecasting models. The key inputs include the estimated future gross cash flow, average cost to collect, and discount rate. In accordance with authoritative guidance related to fair value measurements, the Company estimates the average cost to collect and discount rates based on its estimate of what a market participant might use in valuing these portfolios. The determination of such inputs requires significant judgment, including assessing the assumed market participant's cost structure, its determination of whether to include fixed costs in its valuation, its collection strategies, and determining the appropriate weighted average cost of capital. The Company evaluates the use of these key inputs on an ongoing basis and refines the data as it continues to obtain better information from market participants in the debt recovery and purchasing business.

In the Company's current analysis, the fair value of investment in receivable portfolios was approximately \$3,195.9 million and \$3,415.3 million as of June 30, 2018 and December 31, 2017, respectively, as compared to the carrying value of \$3,084.6 million and \$2,890.6 million as of June 30, 2018 and December 31, 2017, respectively. A 100 basis point fluctuation in the cost to collect and discount rate used would result in an increase or decrease in the fair value of U.S. and European portfolios by approximately \$55.1 million and \$71.3 million, respectively, as of June 30, 2018. This fair value calculation does not represent, and should not be construed to represent, the underlying value of the Company or the amount which could be realized if its investment in receivable portfolios were sold.

**Deferred Court Costs:**

The Company capitalizes deferred court costs and provides a reserve for those costs that it believes will ultimately be uncollectible. The carrying value of net deferred court costs approximates fair value.

**Debt:**

The majority of Encore and its subsidiaries' borrowings are carried at historical amounts, adjusted for additional borrowings less principal repayments, which approximate fair value. These borrowings include Encore's senior secured notes and borrowings under its revolving credit and term loan facilities, Cabot's senior secured notes and borrowings under its revolving credit facility, and other borrowings under revolving credit facilities at certain of the Company's other subsidiaries.

Encore's convertible senior notes are carried at historical cost, adjusted for the debt discount. The carrying value of the convertible senior notes was \$455.7 million and \$450.8 million as of June 30, 2018 and December 31, 2017, respectively. The fair value estimate for these convertible senior notes, which incorporates quoted market prices using

Level 2 inputs, was approximately \$475.2 million and \$520.9 million as of June 30, 2018 and December 31, 2017, respectively.

12

---

Table of Contents

Cabot's senior secured notes are carried at historical cost, adjusted for debt discount and debt premium. The carrying value of Cabot's senior secured notes was \$1,186.2 million and \$1,214.6 million, as of June 30, 2018 and December 31, 2017, respectively. The fair value estimate for these senior notes, which incorporates quoted market prices using Level 2 inputs, was \$1,202.4 million and \$1,258.9 million as of June 30, 2018 and December 31, 2017, respectively.

The Company's preferred equity certificates are legal obligations to the noncontrolling shareholders of certain subsidiaries. They are carried at the face amount, plus any accrued interest. The Company determined that the carrying value of these preferred equity certificates approximated fair value as of June 30, 2018 and December 31, 2017.

**Note 4: Derivatives and Hedging Instruments**

The Company may periodically enter into derivative financial instruments to manage risks related to interest rates and foreign currency. Certain of the Company's derivative financial instruments qualify for hedge accounting treatment under the authoritative guidance for derivatives and hedging.

During the second quarter of 2018, the Company early adopted ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities retroactive to January 1, 2018 with no material impact to its financial statements. Periods prior to January 1, 2018 have not been restated. The Company applies hedge accounting when derivatives are designated, qualified and highly effective as hedges. Effectiveness is formally assessed and documented at inception and each period throughout the life of a hedge using various qualitative or quantitative methods appropriate for each hedge. Under hedge accounting, the changes in fair value of the derivative and the hedged risk are generally recognized together and offset each other when reported in shareholders' net income. Changes in the fair value of a derivative instrument may not always equal changes in the fair value of the hedged item. This is referred to as "hedge ineffectiveness" and, with the adoption of ASU 2017-12, is no longer measured and reported separately from the effective portion of the hedge. The Company excludes certain components of derivative instruments' changes in fair value from the assessment of hedge effectiveness. With the adoption of ASU 2017-12, those excluded components are initially recorded in other comprehensive income and recognized in shareholders' net income over the life of the derivative instrument. The Company did not record a cumulative-effect adjustment on January 1, 2018 (that would have impacted retained earnings and accumulated other comprehensive income by the same amount upon adoption) because there was no ineffectiveness recognized for hedges existing at that date.

The following table summarizes the fair value of derivative instruments as recorded in the Company's condensed consolidated statements of financial condition (in thousands):

	June 30, 2018		December 31, 2017	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:				
Foreign currency exchange contracts	Other assets	\$ 377	Other assets	\$ 1,912
Foreign currency exchange contracts	Other liabilities	(633 )	Other liabilities	—
Interest rate swap agreements	Other assets	10	Other liabilities	(7 )
Derivatives not designated as hedging instruments:				
Foreign currency exchange contracts	Other assets	658	Other assets	—
Foreign currency exchange contracts	Other liabilities	(6,578 )	Other liabilities	(1,110 )
Interest rate cap contracts	Other assets	2,191	Other assets	3,922

**Derivatives Designated as Hedging Instruments**

The Company has operations in foreign countries, which expose the Company to foreign currency exchange rate fluctuations due to transactions denominated in foreign currencies. To mitigate a portion of this risk, the Company enters into derivative financial instruments, principally foreign currency forward contracts with financial counterparties. The Company adjusts the level and use of derivatives as soon as practicable after learning that an exposure has changed and reviews all exposures and derivative positions on an ongoing basis.

Certain of the foreign currency forward contracts are designated as cash flow hedging instruments and qualify for hedge accounting treatment. Gains and losses arising from such contracts are recorded as a component of accumulated other comprehensive income ("OCI") as gains and losses on derivative instruments, net of income taxes. The hedging

gains and losses in OCI are subsequently reclassified into earnings in the same period in which the underlying transactions affect the

13

---

Table of Contents

Company's earnings. If all or a portion of the forecasted transaction is cancelled, the Company would reclassify the hedge into earnings.

As of June 30, 2018, the total notional amount of the forward contracts that are designated as cash flow hedging instruments was \$26.4 million. All of these outstanding contracts qualified for hedge accounting treatment. The Company estimates that approximately \$0.3 million of net derivative loss included in OCI will be reclassified into earnings within the next 12 months. No gains or losses were reclassified from OCI into earnings as a result of forecasted transactions that failed to occur during the six months ended June 30, 2018 and 2017.

The Company may periodically enter into interest rate swap agreements to reduce its exposure to fluctuations in interest rates on variable interest rate debt and their impact on earnings and cash flows. As of June 30, 2018, there were two interest rate swap agreements outstanding with a total notional amount of \$30.0 million Australian dollars (approximately \$22.2 million U.S. dollars). The interest rate swap instrument is designated as a cash flow hedge and accounted for using hedge accounting.

The following table summarizes the effects of derivatives in cash flow hedging relationships designated as hedging instruments on the Company's condensed consolidated statements of operations for the three and six months ended June 30, 2018 and 2017 (in thousands):

Derivatives Designated as Hedging Instruments	Gain or (Loss) Recognized in OCI		Location of Gain or (Loss) Reclassified from OCI into Income	Gain or (Loss) Reclassified from OCI into Income		
	Three Months Ended June 30,	2018		2017	Three Months Ended June 30,	2018
Foreign currency exchange contracts	\$ (967 )	\$ 1,146	Salaries and employee benefits	\$ 434	\$ 297	
Foreign currency exchange contracts	(76 )	160	General and administrative expenses	35	27	
Interest rate swap agreements	(21 )	14	Interest expense	8	33	
Derivatives Designated as Hedging Instruments	Gain or (Loss) Recognized in OCI		Location of Gain or (Loss) Reclassified from OCI into Income	Gain or (Loss) Reclassified from OCI into Income		
	Six Months Ended June 30,	2018		2017	Six Months Ended June 30,	2018
Foreign currency exchange contracts	\$ (1,074 )	\$ 1,735	Salaries and employee benefits	\$ 983	\$ 472	
Foreign currency exchange contracts	(76 )	240	General and administrative expenses	35	41	
Interest rate swap agreements	(12 )	19	Interest expense	25	110	

#### Derivatives Not Designated as Hedging Instruments

On May 8, 2018, in anticipation of the completion of the Cabot Transaction, Encore entered into a foreign exchange forward contract with a notional amount of £176.0 million, which was approximately the amount of the cash consideration for the Cabot Transaction. As of June 30, 2018, the fair value of the forward contract was a liability of approximately \$6.6 million and was recognized as other expenses in the Company's consolidated statements of operations during the three and six months ended June 30, 2018. The forward contract settled on August 3, 2018 at a total loss of \$9.3 million. This loss was substantially offset by a decrease in the final purchase price in U.S. dollars for



the Cabot Transaction.

The Company enters into currency exchange forward contracts to reduce the effects of currency exchange rate fluctuations between the British Pound and Euro. These derivative contracts generally mature within one to three months and are not designated as hedge instruments for accounting purposes. The Company continues to monitor the level of exposure of the foreign currency exchange risk and may enter into additional short-term forward contracts on an ongoing basis. The gains or losses on these derivative contracts are recognized in other income or expense based on the changes in fair value. The Company also holds two interest rate cap contracts with an aggregate notional amount of £300.0 million (approximately \$396.2 million) that are used to manage its risk related to interest rate fluctuations. The Company does not apply hedge accounting on the interest rate cap contracts.

14

---

Table of Contents

The following table summarizes the effects of derivatives in cash flow hedging relationships not designated as hedging instruments on the Company's condensed consolidated statements of operations for the three and six months ended June 30, 2018 and 2017 (in thousands):

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative			
		Three Months Ended June 30,		Six Months Ended June 30,	
		2018	2017	2018	2017
Foreign currency exchange contracts	Other (expense) income	\$(6,174)	\$2,875	\$(6,940)	\$2,623
Interest rate cap contracts	Interest expense	(1,628 )	—	(1,716 )	—
Interest rate swap agreements	Interest expense	—	33	—	110

Note 5: Investment in Receivable Portfolios, Net

In accordance with the authoritative guidance for loans and debt securities acquired with deteriorated credit quality, discrete receivable portfolio purchases during the same fiscal quarter are aggregated into pools based on common risk characteristics. Common risk characteristics include risk ratings (e.g. FICO or similar scores), financial asset type, collateral type, size, interest rate, date of origination, term, and geographic location. The Company's static pools are typically grouped into credit card, purchased consumer bankruptcy, and mortgage portfolios. The Company further groups these static pools by geographic region or location. Portfolios acquired in business combinations are also grouped into these pools. During any fiscal quarter in which the Company has an acquisition of an entity that has portfolio, the entire historical portfolio of the acquired company is aggregated into the pool groups for that quarter, based on common characteristics, resulting in pools for that quarter that may consist of several different vintages of portfolio. Once a static pool is established, the portfolios are permanently assigned to the pool. The discount (i.e., the difference between the cost of each static pool and the related aggregate contractual receivable balance) is not recorded because the Company expects to collect a relatively small percentage of each static pool's contractual receivable balance. As a result, receivable portfolios are recorded at cost at the time of acquisition. The purchase cost of the portfolios includes certain fees paid to third parties incurred in connection with the direct acquisition of the receivable portfolios.

In compliance with the authoritative guidance, the Company accounts for its investments in receivable portfolios using either the interest method or the cost recovery method. The interest method applies an internal rate of return ("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 recognized prospectively through an upward adjustment of the pool's IRR over its remaining life. Subsequent decreases in expected cash flows do not change the IRR, but are recognized as an allowance to the cost basis of the pool, and are reflected in the consolidated statements of operations as a reduction in revenue, with a corresponding valuation allowance, offsetting the investment in receivable portfolios in the consolidated statements of financial condition. With gross collections being discounted at monthly IRRs, when collections are lower in the near term, even if substantially higher collections are expected later in the collection curve, an allowance charge could result.

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

If the amount and timing of future cash collections on a pool of receivables are not reasonably estimable, the Company accounts for such portfolios on the cost recovery method as Cost Recovery Portfolios. The accounts in these portfolios have different risk characteristics than those included in other portfolios acquired during the same quarter, or the necessary information was not available to estimate future cash flows and, accordingly, they were not aggregated with other portfolios. Under the cost recovery method of accounting, no revenue is recognized until the

carrying value of a Cost Recovery Portfolio has been fully recovered.

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

Table of Contents

The following table summarizes the Company's accretible yield and an estimate of zero basis future cash flows at the beginning and end of the period presented (in thousands):

	Accretible Yield	Estimate of Zero Basis Cash Flows	Total
Balance at December 31, 2017	\$3,695,069	\$369,632	\$4,064,701
Revenue from receivable portfolios	(249,821 )	(31,188 )	(281,009 )
Allowance reversals on receivable portfolios, net	(8,082 )	(1,729 )	(9,811 )
Reductions on existing portfolios, net	(24,945 )	(39,529 )	(64,474 )
Additions for current purchases	285,172	—	285,172
Effect of foreign currency translation	57,577	643	58,220
Balance at March 31, 2018	3,754,970	297,829	4,052,799
Revenue from receivable portfolios	(258,698 )	(33,964 )	(292,662 )
Allowance reversals on receivable portfolios, net	(15,411 )	(2,221 )	(17,632 )
Additions on existing portfolios, net	136,267	5,824	142,091
Additions for current purchases	345,006	—	345,006
Effect of foreign currency translation	(97,448 )	(597 )	(98,045 )
Balance at June 30, 2018	\$3,864,686	\$266,871	\$4,131,557
	Accretible Yield	Estimate of Zero Basis Cash Flows	Total
Balance at December 31, 2016	\$3,092,004	\$365,504	\$3,457,508
Revenue from receivable portfolios	(211,105 )	(38,733 )	(249,838 )
Allowance reversals on receivable portfolios, net	(613 )	(1,519 )	(2,132 )
(Reductions) additions on existing portfolios, net	(90,138 )	57,446	(32,692 )
Additions for current purchases	200,728	—	200,728
Effect of foreign currency translation	38,712	467	39,179
Balance at March 31, 2017	3,029,588	383,165	3,412,753
Revenue from receivable portfolios	(224,310 )	(39,097 )	(263,407 )
Allowance reversals on receivable portfolios, net	(7,121 )	(1,708 )	(8,829 )
Additions on existing portfolios, net	225,021	9,888	234,909
Additions for current purchases	258,687	—	258,687
Effect of foreign currency translation	66,927	(753 )	66,174
Balance at June 30, 2017	\$3,348,792	\$351,495	\$3,700,287

During the three months ended June 30, 2018, the Company purchased receivable portfolios with a face value of \$2.9 billion for \$359.6 million, or a purchase cost of 12.5% of face value. The estimated future collections at acquisition for all portfolios purchased during the three months ended June 30, 2018 amounted to \$704.4 million. During the three months ended June 30, 2017, the Company purchased receivable portfolios with a face value of \$2.4 billion for \$246.4 million, or a purchase cost of 10.1% of face value. The estimated future collections at acquisition for all portfolios purchased during the three months ended June 30, 2017 amounted to \$505.0 million.

During the six months ended June 30, 2018, the Company purchased receivable portfolios with a face value of \$4.7 billion for \$636.3 million, or a purchase cost of 13.6% of face value. The estimated future collections at acquisition for all portfolios purchased during the six months ended June 30, 2018 amounted to \$1,260.6 million. During the six months ended June 30, 2017, the Company purchased receivable portfolios with a face value of \$4.1 billion for \$465.1 million, or a purchase cost of 11.3% of face value. The estimated future collections at acquisition for all portfolios purchased during the six months ended June 30, 2017 amounted to \$924.4 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 June 30, 2018 and 2017, Zero Basis Revenue was



Table of Contents

approximately \$34.0 million and \$39.1 million, respectively. During the three months ended June 30, 2018 and 2017, allowance reversals on Zero Basis Portfolios were \$2.2 million and \$1.7 million, respectively.

During the six months ended June 30, 2018 and 2017, Zero Basis Revenue was approximately \$65.2 million and \$77.8 million, respectively. During the six months ended June 30, 2018 and 2017, allowance reversals on Zero Basis Portfolios were \$4.0 million and \$3.2 million, respectively.

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

	Three Months Ended June 30, 2018			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$3,013,519	\$ 10,622	\$ —	\$3,024,141
Purchases of receivable portfolios	359,580	—	—	359,580
Disposals or transfers to assets held for sale	(2,033 )	(262 )	—	(2,295 )
Gross collections <sup>(1)</sup>	(460,478 )	(252 )	(35,363 )	(496,093 )
Put-backs and Recalls <sup>(2)</sup>	(8,484 )	—	(24 )	(8,508 )
Foreign currency adjustments	(101,921 )	(577 )	—	(102,498 )
Revenue recognized	258,698	—	33,964	292,662
Reclassification adjustments <sup>(3)</sup>	—	798	(798)	—
Portfolio allowance reversals, net	15,411	—	2,221	17,632
Balance, end of period	\$3,074,292	\$ 10,329	\$ —	\$3,084,621
Revenue as a percentage of collections <sup>(4)</sup>	56.2 %	0.0 %	96.0 %	59.0 %
	Three Months Ended June 30, 2017			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$2,422,299	\$ 13,719	\$ —	\$2,436,018
Purchases of receivable portfolios	245,246	1,169	—	246,415
Disposals or transfers to assets held for sale	(2,697 )	—	—	(2,697 )
Gross collections <sup>(1)</sup>	(404,918 )	(459 )	(40,805 )	(446,182 )
Put-backs and Recalls <sup>(2)</sup>	(3,237 )	—	—	(3,237 )
Foreign currency adjustments	53,466	(94 )	—	53,372
Revenue recognized	224,310	—	39,097	263,407
Portfolio allowance reversals, net	7,121	—	1,708	8,829
Balance, end of period	\$2,541,590	\$ 14,335	\$ —	\$2,555,925
Revenue as a percentage of collections <sup>(4)</sup>	55.4 %	0.0 %	95.8 %	59.0 %

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

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

(3) Reclassification relating to certain Zero Basis Revenue that was classified as collections in cost recovery portfolios in prior periods.

(4) Revenue as a percentage of collections excludes the effects of net portfolio allowances or net portfolio allowance reversals.

Table of Contents

	Six Months Ended June 30, 2018			Total
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	
Balance, beginning of period	\$2,879,170	\$ 11,443	\$ —	\$2,890,613
Purchases of receivable portfolios	636,342	—	—	636,342
Disposals or transfers to held for sale	(5,105 )	(262 )	—	(5,367 )
Gross collections <sup>(1)</sup>	(915,621 )	(1,423 )	(68,151 )	(985,195 )
Put-backs and Recalls <sup>(2)</sup>	(12,175 )	—	(153 )	(12,328 )
Foreign currency adjustments	(40,331 )	(227 )	—	(40,558 )
Revenue recognized	508,519	—	65,152	573,671
Reclassification adjustments <sup>(3)</sup>	—	798	(798)	—
Portfolio allowance reversals, net	23,493	—	3,950	27,443
Balance, end of period	\$3,074,292	\$ 10,329	\$ —	\$3,084,621
Revenue as a percentage of collections <sup>(4)</sup>	55.5	% 0.0	% 95.6%	58.2 %

	Six Months Ended June 30, 2017			Total
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	
Balance, beginning of period	\$2,368,366	\$ 14,443	\$ —	\$2,382,809
Purchases of receivable portfolios	463,973	1,169	—	465,142
Disposals or transfers to held for sale	(7,468 )	—	—	(7,468 )
Gross collections <sup>(1)</sup>	(804,922 )	(1,099 )	(81,024 )	(887,045 )
Put-backs and Recalls <sup>(2)</sup>	(4,994 )	—	(33 )	(5,027 )
Foreign currency adjustments	83,486	(178 )	—	83,308
Revenue recognized	435,415	—	77,830	513,245
Portfolio allowance reversals, net	7,734	—	3,227	10,961
Balance, end of period	\$2,541,590	\$ 14,335	\$ —	\$2,555,925
Revenue as a percentage of collections <sup>(4)</sup>	54.1	% 0.0	% 96.1%	57.9 %

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

Put-backs represent accounts that are returned to the seller in accordance with the respective purchase agreement

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

(3) Reclassification relating to certain Zero Basis Revenue that was classified as collections in cost recovery portfolios in prior periods.

(4) Revenue as a percentage of collections excludes the effects of net portfolio allowances or net portfolio allowance reversals.

The following table summarizes the change in the valuation allowance for investment in receivable portfolios during the periods presented (in thousands):

	Valuation Allowance			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Balance at beginning of period	\$94,317	\$136,325	\$102,576	\$137,037
Provision for portfolio allowances	1,720	682	2,660	682
Reversal of prior allowances	(19,352 )	(9,511 )	(30,103 )	(11,643 )
Effect of foreign currency translation	(1,556 )	3,179	(4 )	4,599
Balance at end of period	\$75,129	\$130,675	\$75,129	\$130,675





Table of Contents

## Note 6: Deferred Court Costs, Net

The Company pursues legal collections using a network of attorneys that specialize in collection matters and through its internal legal channel. The Company generally pursues collections through legal means only when it believes a consumer has sufficient assets to repay their indebtedness but has, to date, been unwilling to pay. In order to pursue legal collections the Company is required to pay certain upfront costs to the applicable courts that are recoverable from the consumer (“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 an estimated court cost recovery rate established based on its analysis of historical court costs recovery data. The Company estimates deferral periods for Deferred Court Costs based on jurisdiction and nature of litigation and writes off any Deferred Court Costs not recovered within the respective deferral period. Collections received from debtors are first applied against related court costs with the balance applied to the debtors’ account balance.

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

	June 30, 2018	December 31, 2017
Court costs advanced	\$790,085	\$ 743,584
Court costs recovered	(318,088 )	(299,606 )
Court costs reserve	(381,125 )	(364,015 )
Deferred court costs	\$90,872	\$ 79,963

A roll forward of the Company’s court cost reserve is as follows (in thousands):

	Court Cost Reserve			
	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Balance at beginning of period	\$(378,190)	\$(334,639)	\$(364,015)	\$(327,926)
Provision for court costs	(19,161 )	(22,197 )	(44,234 )	(40,202 )
Net down of reserve after deferral period	12,435	12,488	25,387	24,511
Effect of foreign currency translation	3,791	(1,623 )	1,737	(2,354 )
Balance at end of period	\$(381,125)	\$(345,971)	\$(381,125)	\$(345,971)

Table of Contents

## Note 7: Other Assets

Other assets consist of the following (in thousands):

	June 30, 2018	December 31, 2017
Identifiable intangible assets, net	\$67,186	\$ 75,736
Prepaid expenses	27,653	27,606
Service fee receivables	24,748	25,609
Assets held for sale	24,063	18,741
Deferred tax assets	21,316	18,773
Other financial receivables	7,798	18,997
Derivative instruments	3,236	5,834
Security deposits	3,182	3,451
Funds held in escrow	—	28,199
Prepaid income taxes	—	27,917
Other	71,741	51,865
Total	\$250,923	\$ 302,728

## Note 8: Debt, Net

The Company is in compliance with all covenants under its financing arrangements as of June 30, 2018. The components of the Company's consolidated debt and capital lease obligations were as follows (in thousands):

	June 30, 2018	December 31, 2017
Encore revolving credit facility	\$376,000	\$ 328,961
Encore term loan facility	200,799	181,687
Encore senior secured notes	325,000	326,029
Encore convertible notes	483,500	483,500
Less: debt discount	(27,828 )	(32,720 )
Cabot senior secured notes	1,188,074	1,216,485
Less: debt discount	(1,877 )	(1,927 )
Cabot senior revolving credit facility	243,900	179,008
Cabot securitisation senior facility	383,003	391,790
Preferred equity certificates	262,379	253,324
Other credit facilities	59,241	68,001
Other	71,212	92,792
Capital lease obligations	7,630	6,069
	3,571,033	3,492,999
Less: debt issuance costs, net of amortization	(40,618 )	(46,123 )
Total	\$3,530,415	\$ 3,446,876

## Encore Revolving Credit Facility and Term Loan Facility

The Company has a revolving credit facility and term loan facility pursuant to a Third Amended and Restated Credit Agreement dated December 20, 2016 (as amended, the "Restated Credit Agreement"). The Restated Credit Agreement includes a revolving credit facility of \$794.6 million (the "Revolving Credit Facility"), a term loan facility of \$203.7 million (the "Term Loan Facility", and together with the Revolving Credit Facility, the "Senior Secured Credit Facilities"), and an accordion feature that allows the Company to increase the Senior Secured Credit Facilities by an additional \$250.0 million (approximately \$150.3 million of which has been exercised).

Table of Contents

Provisions of the Restated Credit Agreement as of June 30, 2018 include, but are not limited to:

Revolving Credit Facility commitments of (1) \$677.1 million that expire in December 2021 and (2) \$117.6 million that expire in February 2019, in each case with interest at a floating rate equal to, at the Company's option, either: (a) reserve adjusted London Interbank Offered Rate ("LIBOR"), plus a spread that ranges from 250 to 300 basis points depending on the cash flow leverage ratio of Encore and its restricted subsidiaries; or (b) alternate base rate, plus a spread that ranges from 150 to 200 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries. "Alternate base rate," as defined in the Restated Credit Agreement, means the highest of (i) the per annum rate which the administrative agent publicly announces from time to time as its prime lending rate, (ii) the federal funds effective rate from time to time, plus 0.5% per annum, (iii) reserved adjusted LIBOR determined on a daily basis for a one month interest period, plus 1.0% per annum and (iv) zero;

A \$194.6 million term loan maturing in December 2021, with interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted LIBOR, plus a spread that ranges from 250 to 300 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries; or (2) alternate base rate, plus a spread that ranges from 150 to 200 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries.

Principal amortizes \$5.1 million in 2018 and \$15.3 million in each of 2019 and 2020 with the remaining principal due in 2021;

A \$9.1 million term loan maturing in February 2019, with interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted LIBOR, plus a spread that ranges from 250 to 300 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries; or (2) alternate base rate, plus a spread that ranges from 150 to 200 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries. Principal amortizes \$0.6 million in 2018 with the remaining principal due in 2019;

A borrowing base under the Revolving Credit Facility equal to 35% of all eligible non-bankruptcy estimated remaining collections plus 55% of eligible estimated remaining collections for consumer receivables subject to bankruptcy;

• A maximum cash flow leverage ratio permitted of 3.00:1.00;

• A maximum cash flow first-lien leverage ratio of 2.00:1.00;

• A minimum interest coverage ratio of 1.75:1.00;

• The allowance of indebtedness in the form of senior secured notes not to exceed \$350.0 million;

• The allowance of additional unsecured or subordinated indebtedness not to exceed \$1.1 billion, including junior lien indebtedness not to exceed \$400.0 million;

• Restrictions and covenants, which limit the payment of dividends and the incurrence of additional indebtedness and liens, among other limitations;

• Repurchases of up to \$150.0 million of Encore's common stock after July 9, 2015, subject to compliance with certain covenants and available borrowing capacity;

• A change of control definition, that excludes acquisitions of stock by Red Mountain Capital Partners LLC, JCF FPK I, LP and their respective affiliates of up to 50% of the outstanding shares of Encore's voting stock;

• Events of default which, upon occurrence, may permit the lenders to terminate the facility and declare all amounts outstanding to be immediately due and payable;

• A pre-approved acquisition limit of \$225.0 million per fiscal year;

A basket to allow for investments not to exceed the greater of (1) 200% of the consolidated net worth of Encore and its restricted subsidiaries; and (2) an unlimited amount such that after giving effect to the making of any investment, the cash flow leverage ratio is less than 1.25:1:00;

• A basket to allow for investments in persons organized under the laws of Canada in the amount of \$50.0 million;

• A requirement that Encore and its restricted subsidiaries, for the four-month period ending February 2019, have sufficient cash or availability under the Revolving Credit Facility (excluding availability under revolving

Table of Contents

commitments expiring in February 2019) to satisfy any amounts due under the revolving commitments that expire in February 2019 and the sub-tranche of the Term Loan Facility that expires in February 2019;

• Collateralization by all assets of the Company, other than the assets of certain foreign subsidiaries and all unrestricted subsidiaries as defined in the Restated Credit Agreement.

At June 30, 2018, the outstanding balance under the Revolving Credit Facility was \$376.0 million, which bore a weighted average interest rate of 4.92% and 4.06% for the three months ended June 30, 2018 and 2017, respectively, and 4.78% and 3.90% for the six months ended June 30, 2018 and 2017, respectively. Available capacity under the Revolving Credit Facility, after taking into account borrowing base and applicable debt covenants, was \$243.5 million as of June 30, 2018. At June 30, 2018, the outstanding balance under the Term Loan Facility was \$200.8 million.

**Encore Senior Secured Notes**

In August 2017, Encore entered into \$325.0 million in senior secured notes with a group of insurance companies (the “Senior Secured Notes”). The Senior Secured Notes bear an annual interest rate of 5.625%, mature in 2024 and beginning in November 2019 will require quarterly principal payments of \$16.3 million. As of June 30, 2018, \$325.0 million of the Senior Secured Notes remained outstanding.

The Senior Secured Notes are guaranteed in full by certain of Encore’s subsidiaries. The Senior Secured Notes are pari passu with, and are collateralized by the same collateral as, the Senior Secured Credit Facilities. The Senior Secured Notes may be accelerated and become automatically and immediately due and payable upon certain events of default, including certain events related to insolvency, bankruptcy, or liquidation. Additionally, any series of the Senior Secured Notes may be accelerated at the election of the holder or holders of a majority in principal amount of such series of Senior Secured Notes upon certain events of default by Encore, including the breach of affirmative covenants regarding guarantors, collateral, minimum revolving credit facility commitment or the breach of any negative covenant. Encore may prepay the Senior Secured Notes at any time for any reason. If Encore prepays the Senior Secured Notes, payment will be at the higher of par or the present value of the remaining scheduled payments of principal and interest on the portion being prepaid. The discount rate used to determine the present value is 50 basis points over the then current Treasury Rate corresponding to the remaining average life of the Senior Secured Notes. The covenants and material terms in the purchase agreement for the Senior Secured Notes are substantially similar to those in the Restated Credit Agreement. The holders of the Senior Secured Notes and the administrative agent for the lenders of the Restated Credit Agreement have an intercreditor agreement related to their pro rata rights to the collateral, actionable default, powers and duties and remedies, among other topics.

**Encore Convertible Notes**

In June and July 2013, Encore sold \$172.5 million aggregate principal amount of 3.0% 2020 Convertible Notes that mature on July 1, 2020 in private placement transactions (the “2020 Convertible Notes”). In March 2014, Encore sold \$161.0 million aggregate principal amount of 2.875% 2021 Convertible Notes that mature on March 15, 2021 in private placement transactions (the “2021 Convertible Notes”). In March 2017, Encore sold \$150.0 million aggregate principal amount of 3.25% 2022 Convertible Senior Notes that mature on March 15, 2022 in private placement transactions (the “2022 Convertible Notes” and together with the 2020 Convertible Notes and the 2021 Convertible Notes, the “Convertible Notes”). The interest on the Convertible Notes is payable semi-annually.

Prior to the close of business on the business day immediately preceding their respective conversion date (listed below), holders may convert their Convertible Notes under certain circumstances set forth in the applicable Convertible Notes indentures. On or after their respective conversion dates until the close of business on the scheduled trading day immediately preceding their respective maturity date, holders may convert their Convertible Notes at any time. Certain key terms related to the convertible features for each of the Convertible Notes as of June 30, 2018 are listed below.

	2020 Convertible Notes	2021 Convertible Notes	2022 Convertible Notes
Initial conversion price	\$ 45.72	\$ 59.39	\$ 45.57
Closing stock price at date of issuance	\$ 33.35	\$ 47.51	\$ 35.05
Closing stock price date			

Edgar Filing: ENCORE CAPITAL GROUP INC - Form 10-Q

	June 24, 2013	March 5, 2014	February 27, 2017
Conversion rate (shares per \$1,000 principal amount)	21.8718	16.8386	21.9467
Conversion date	January 1, 2020	September 15, 2020	September 15, 2021

In the event of conversion, holders of the Company's Convertible Notes will receive cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election. The

Table of Contents

Company's current intent is to settle conversions through combination settlement (i.e., convertible into cash up to the aggregate principal amount, and shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election, for the remainder). As a result, and in accordance with authoritative guidance related to derivatives and hedging and earnings per share, only the conversion spread is included in the diluted earnings per share calculation, if dilutive. Under such method, the settlement of the conversion spread has a dilutive effect when, during any quarter, the average share price of the Company's common stock exceeds the initial conversion prices listed in the above table.

Authoritative guidance requires that issuers of convertible debt instruments which, 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.

The debt and equity components, the issuance costs related to the equity component, the stated interest rate, and the effective interest rate for each of the Convertible Notes are listed below (in thousands, except percentages):

	2020	2021	2022		
	Convertible	Convertible	Convertible		
	Notes	Notes	Notes		
Debt component	\$ 140,247	\$ 143,645	\$ 137,266		
Equity component	\$ 32,253	\$ 17,355	\$ 12,734		
Equity issuance cost	\$ 1,106	\$ 581	\$ 398		
Stated interest rate	3.000	% 2.875	% 3.250	%	
Effective interest rate	6.350	% 4.700	% 5.200	%	

The balances of the liability and equity components of all of the Convertible Notes outstanding were as follows (in thousands):

	June 30, 2018	December 31, 2017
Liability component—principal amount	\$ 483,500	\$ 483,500
Unamortized debt discount	(27,828 )	(32,720 )
Liability component—net carrying amount	\$ 455,672	\$ 450,780
Equity component	\$ 62,696	\$ 62,696

The debt discount is being amortized into interest expense over the remaining life of the convertible notes using the effective interest rates. Interest expense related to the convertible notes was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Interest expense—stated coupon rate	\$ 3,651	\$ 4,064	\$ 7,293	\$ 7,588
Interest expense—amortization of debt discount	2,464	2,415	4,892	4,901
Total interest expense—convertible notes	\$ 6,115	\$ 6,479	\$ 12,185	\$ 12,489

**Convertible Notes Hedge Transactions**

In order to reduce the risk related to the potential dilution and/or the potential cash payments the Company may be required to make in the event that the market price of the Company's common stock becomes greater than the conversion prices of the Convertible Notes, the Company maintains a hedge program that increases the effective conversion price for each of the 2020 Convertible Notes and 2021 Convertible Notes. The Company did not hedge the 2022 Convertible Notes. All of the hedge instruments related to the Convertible Notes have been determined to be indexed to the Company's own stock and meet the criteria for equity classification. In accordance with authoritative guidance, the Company recorded the cost of the hedge instruments as a reduction in additional paid-in capital, and will not recognize subsequent changes in fair value of these financial instruments in its consolidated financial statements.

The details of the hedge program for each of the Convertible Notes are listed below (in thousands, except conversion price):

23

---

Table of Contents

	2020	2021
	Convertible	Convertible
	Notes	Notes
Cost of the hedge transaction(s)	\$ 18,113	\$ 19,545
Initial conversion price	\$ 45.72	\$ 59.39
Effective conversion price	\$ 61.55	\$ 83.14

**Cabot Senior Secured Notes**

On August 2, 2013, Cabot Financial (Luxembourg) S.A. (“Cabot Financial”), an indirect subsidiary of Encore, issued £100.0 million (approximately \$151.7 million) in aggregate principal amount of 8.375% Senior Secured Notes due 2020 (the “Cabot 2020 Notes”). Interest on the Cabot 2020 Notes is payable semi-annually, in arrears, on February 1 and August 1 of each year. On July 18, 2018, Cabot Financial completed an exchange offer for a portion of these outstanding notes. Refer to Note 15, “Subsequent Events” for further details.

On March 27, 2014, Cabot Financial issued £175.0 million (approximately \$291.8 million) in aggregate principal amount of 6.500% Senior Secured Notes due 2021 (the “Cabot 2021 Notes”). Interest on the Cabot 2021 Notes is payable semi-annually, in arrears, on April 1 and October 1 of each year. On July 18, 2018, Cabot Financial completed an exchange offer for a portion of these outstanding notes. Refer to Note 15, “Subsequent Events” for further details.

On October 6, 2016, Cabot Financial issued £350.0 million (approximately \$442.6 million) in aggregate principal amount of 7.500% Senior Secured Notes due 2023 (the “Cabot 2023 Notes” and together with the Cabot 2020 Notes and the Cabot 2021 Notes, the “Cabot Notes”). Interest on the Cabot 2023 Notes is payable semi-annually, in arrears, on April 1 and October 1 of each year. The Cabot 2023 Notes were issued at a price equal to 100% of their face value. The proceeds from the offering were used to (1) redeem in full the Cabot 2019 Notes plus a call premium of £13.7 million (approximately \$17.4 million), (2) partially repay amounts outstanding under Cabot’s revolving credit facility, (3) pay accrued interest on the Cabot 2019 Notes, and (4) pay fees and expenses in relation to the offering of the Cabot 2023 Notes.

The Cabot Notes are fully and unconditionally guaranteed on a senior secured basis by the following indirect subsidiaries of the Company: Cabot Credit Management Limited (“CCM”), Cabot Financial Limited, and all material subsidiaries of Cabot Financial Limited (other than Cabot Financial and Marlin Intermediate Holdings plc). The Cabot Notes are secured by a first ranking security interest in all the outstanding shares of Cabot Financial and the guarantors (other than CCM and Marlin Midway Limited) and substantially all the assets of Cabot Financial and the guarantors (other than CCM). Subject to the Intercreditor Agreement described below under “Cabot Senior Revolving Credit Facility”, the guarantees provided in respect of the Cabot Notes are pari passu with each such guarantee given in respect of the Cabot Floating Rate Notes, Marlin Bonds and the Cabot Credit Facility described below.

On November 11, 2015, Cabot Financial (Luxembourg) II S.A. (“Cabot Financial II”), an indirect subsidiary of Encore, issued €310.0 million (approximately \$332.2 million) in aggregate principal amount of Senior Secured Floating Rate Notes due 2021 (the “Cabot Floating Rate Notes”). The Cabot Floating Rate Notes were issued at a 1%, or €3.1 million (approximately \$3.4 million), original issue discount, which is being amortized over the life of the notes and included as interest expense in the Company’s consolidated statements of operations. The Cabot Floating Rate Notes bear interest at a rate equal to three-month EURIBOR plus 5.875% per annum, reset quarterly. Interest on the Cabot Floating Rate Notes is payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year, beginning on February 15, 2016. The Cabot Floating Rate Notes will mature on November 15, 2021.

The Cabot Floating Rate Notes are fully and unconditionally guaranteed on a senior secured basis by the following indirect subsidiaries of the Company: CCM, Cabot Financial Limited and all material subsidiaries of Cabot Financial Limited (other than Cabot Financial II and Marlin Intermediate Holdings plc). The Cabot Floating Rate Notes are secured by a first-ranking security interest in all the outstanding shares of Cabot Financial II and the guarantors (other than CCM and Marlin Midway Limited) and substantially all the assets of Cabot Financial II and the guarantors (other than CCM).





Table of Contents

Interest expense related to the Cabot senior secured notes was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Interest expense—stated coupon rate	\$21,239	\$25,011	\$42,839	\$48,993
Interest income—accretion of debt premium	—	(1,081)	—	(2,097)
Interest expense—amortization of debt discount	119	116	3	226
Total interest expense—Cabot senior secured notes	\$21,358	\$24,046	\$42,842	\$47,122

At June 30, 2018, the outstanding balance on the Cabot senior secured notes was \$1.2 billion.

**Cabot Senior Revolving Credit Facility**

On December 12, 2017, Cabot Financial (UK) Limited (“Cabot Financial UK”) entered into an amended and restated senior secured revolving credit facility agreement, which provides for a total committed facility of £295.0 million (approximately \$395.2 million) (as amended and restated, the “Cabot Credit Facility”). The Cabot Credit Facility consists of a £245.0 million tranche that expires in September 2021 and a £50.0 million tranche that expires in March 2022, and includes the following key provisions:

- Interest at LIBOR (or EURIBOR for any loan drawn in euro) plus 3.25% per annum, which may decrease to 2.75% upon certain specified conditions;

- A restrictive covenant that limits the loan to value ratio to 0.75 in the event that the Cabot Credit Facility is more than 20% utilized;

- A restrictive covenant that limits the super senior loan (i.e. the Cabot Credit Facility and any super priority hedging liabilities) to value ratio to 0.275 in the event that the Cabot Credit Facility is more than 20% utilized;

- Additional restrictions and covenants which limit, among other things, the payment of dividends and the incurrence of additional indebtedness and liens; and

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

The Cabot Credit Facility is unconditionally guaranteed by the following indirect subsidiaries of the Company: CCM, Cabot Financial Limited, and all material subsidiaries of Cabot Financial Limited. The Cabot Credit Facility is secured by first ranking security interests in all the outstanding shares of Cabot Financial UK and the guarantors (other than CCM) and substantially all the assets of Cabot Financial UK and the guarantors (other than CCM).

Pursuant to the terms of intercreditor agreements entered into with respect to the relative positions of the Cabot Notes, the Cabot Floating Rate Notes and the Cabot Credit Facility, any liabilities in respect of obligations under the Cabot Credit Facility that are secured by assets that also secure the Cabot Notes and the Cabot Floating Rate Notes will receive priority with respect to any proceeds received upon any enforcement action over any such assets.

At June 30, 2018, the outstanding borrowings under the Cabot Credit Facility were approximately \$243.9 million. The weighted average interest rate was 3.68% and 3.50% for the three months ended June 30, 2018 and 2017, respectively, and 3.72% and 3.51% for the six months ended June 30, 2018 and 2017, respectively

**Cabot Securitisation Senior Facility**

Cabot Securitisation has entered into a senior facility agreement (the “Senior Facility Agreement”) for a committed amount of £300.0 million, of which £290.0 million was drawn as of June 30, 2018. The Senior Facility Agreement has an initial availability period ending in September 2020 and an initial repayment date in September 2022. The obligations of Cabot Securitisation under the Senior Facility Agreement are secured by first ranking security interests over all of Cabot Securitisation’s property, assets and rights (including receivables purchased from Cabot Financial UK from time to time), the book value of which was approximately £313.5 million (approximately \$414.0 million) as of June 30, 2018. Funds drawn under the Senior Facility Agreement will bear interest at a rate per annum equal to LIBOR plus a margin of 2.85%.

At June 30, 2018, the outstanding borrowings under the Cabot Securitisation Senior Facility were approximately \$383.0 million. The weighted average interest rate was 3.35% for the three and six months ended June 30, 2018.



Table of Contents

## Preferred Equity Certificates

On July 1, 2013, the Company, through its wholly owned subsidiary Encore Europe Holdings, S.à r.l. (“Encore Europe”), completed the acquisition of Cabot (the “Cabot Acquisition”) by acquiring 50.1% of the equity interest in Janus Holdings Luxembourg S.à r.l. (“Janus Holdings”). Encore Europe purchased from J.C. Flowers & Co. LLC (“J.C. Flowers”): (i) E Bridge preferred equity certificates issued by Janus Holdings, with a face value of £10,218,574 (approximately \$15.5 million) (and any accrued interest thereof) (the “E Bridge PECs”), (ii) E preferred equity certificates issued by Janus Holdings with a face value of £96,729,661 (approximately \$147.1 million) (and any accrued interest thereof) (the “E PECs”), (iii) 3,498,563 E shares of Janus Holdings (the “E Shares”), and (iv) 100 A shares of Cabot Holdings S.a r.l. (“Cabot Holdings”), the direct subsidiary of Janus Holdings, for an aggregate purchase price of approximately £115.1 million (approximately \$175.0 million). The E Bridge PECs, E PECs, and E Shares represent 50.1% of all of the issued and outstanding equity and debt securities of Janus Holdings. The remaining 49.9% of Janus Holdings’ equity and debt securities are owned by J.C. Flowers and include: (a) J Bridge PECs with a face value of £10,177,781 (approximately \$15.5 million), (b) J preferred equity certificates with a face value of £96,343,515 (approximately \$146.5 million) (the “J PECs”), (c) 3,484,597 J shares of Janus Holdings (the “J Shares”), and (d) 100 A shares of Cabot Holdings.

All of the PECs accrue interest at 12% per annum. Since PECs are legal form debt, the J Bridge PECs, J PECs and any accrued interests thereof are classified as liabilities and are included in debt in the Company’s accompanying condensed consolidated statements of financial condition. In addition, certain other minority owners hold PECs at the Cabot Holdings level (the “Management PECs”). These PECs are also included in debt in the Company’s accompanying condensed consolidated statements of financial condition. The E Bridge PECs and E PECs held by the Company, and their related interest eliminate in consolidation and therefore are not included in debt in the Company’s condensed consolidated statements of financial condition. The J Bridge PECs, J PECs, and the Management PECs do not require the payment of cash interest expense as they have characteristics similar to equity with a preferred return. The ultimate payment of the accumulated interest would be satisfied only in connection with the disposition of the noncontrolling interest of J.C. Flowers and management.

On June 20, 2014, Encore Europe converted all of its E Bridge PECs into E Shares and E PECs, and J.C. Flowers converted all of its J Bridge PECs into J Shares and J PECs in proportion to the number of E Shares and E PECs, or J Shares and J PECs, as applicable, outstanding on the closing date of the Cabot Acquisition.

As of June 30, 2018, the outstanding balance of the PECs, including accrued interest, was approximately \$262.4 million.

## Capital Lease Obligations

The Company has capital lease obligations primarily for computer equipment. As of June 30, 2018, the Company’s combined obligations for capital leases were approximately \$7.6 million. These capital lease obligations require monthly, quarterly or annual payments through 2023 and have implicit interest rates that range from 2.4% to approximately 5.2%.

## Note 9: Variable Interest Entities

A VIE is defined as a legal entity whose equity owners do not have sufficient equity at risk, or, as a group, the holders of the equity investment at risk lack any of the following three characteristics: decision-making rights, the obligation to absorb losses, or the right to receive the expected residual returns of the entity. The primary beneficiary is identified as the variable interest holder that has both the power to direct the activities of the VIE that most significantly affect the entity’s economic performance and the obligation to absorb expected losses or the right to receive benefits from the entity that could potentially be significant to the VIE.

The Company’s VIEs include its subsidiary Janus Holdings and other immaterial special purpose entities that were created to purchase receivable portfolios in certain geographies.

Janus Holdings is the indirect parent company of Cabot. The Company has determined that Janus Holdings is a VIE and the Company is the primary beneficiary of the VIE. The key activities that affect Cabot’s economic performance include, but are not limited to, operational budgets and purchasing decisions. Through its control of the board of directors of Janus Holdings, the Company controls the key operating activities at Cabot.

Assets recognized as a result of consolidating these VIEs do not represent additional assets that could be used to satisfy claims against the Company's general assets. Conversely, liabilities recognized as a result of consolidating these VIEs do not represent additional claims on the Company's general assets; rather, they represent claims against the specific assets of the VIE.

The Company evaluates its relationships with its VIEs on an ongoing basis to ensure that it continues to be the primary beneficiary. On July 24, 2018, Cabot became a wholly owned subsidiary of Encore upon the completion of the Cabot

Table of Contents

Transaction. The Company is in the process of evaluating the impact from this VIE reconsideration event. Refer to Note 15, “Subsequent Events” for further details of the Cabot Transaction.

## Note 10: Income Taxes

Income tax expense on income from continuing operations was \$11.3 million and \$13.5 million during the three months ended June 30, 2018 and 2017, respectively, and \$20.8 million and \$25.6 million during the six months ended June 30, 2018 and 2017, respectively.

On December 22, 2017, the U.S. Tax Cuts and Jobs Act (the “Tax Reform Act”) was signed into law by President Trump. The Tax Reform Act significantly revised the U.S. corporate income tax regime by, among other things, lowering the U.S. corporate tax rate from a top rate of 35% to a flat rate of 21% effective January 1, 2018, while also implementing elements of a territorial tax system and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. The decreases in income tax expense for the three and six months ended June 30, 2018 as compared to the corresponding periods in 2017 were primarily due to the reduction of the U.S. corporate tax rate as a result of the Tax Reform Act.

Due to the complexities involved in accounting for the Tax Reform Act, Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”) allowed the Company to record provisional amounts in earnings for the year ended December 31, 2017. SAB 118 provides that where reasonable estimates can be made, the provisional accounting should be based on such estimates. During the three and six months ended June 30, 2018, there were no changes made to the provisional amounts recognized in 2017.

The Tax Reform Act subjects U.S. shareholders to a tax on global intangible low-taxed income (GILTI) earned by certain foreign subsidiaries. Under U.S. GAAP, relating to GILTI, the Company is allowed to make an accounting policy choice to either (1) treat taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred (the “period cost method”) or (2) factor such amounts into the Company’s measurement of deferred taxes (the “deferred method”). The Company has elected to treat taxes due on future U.S. inclusions in taxable income as a current period expense at June 30, 2018. The Company has reasonably estimated provisional amounts related to GILTI, based on current year operations only, and has included such amounts in its financial statements.

The Company will continue to analyze the effects of the Tax Reform Act, including the effects of GILTI, and additional impacts, if any. The impact of the Tax Reform Act may differ from the Company’s estimates, possibly materially, during the one-year measurement period due to, among other things, further refinement of the Company’s calculations, changes in interpretations and assumptions the Company has made, guidance that may be issued and actions the Company may take as a result of the Tax Reform Act.

The effective tax rates for the respective periods are shown below:

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Federal provision	21.0 %	35.0%	21.0 %	35.0%
State provision	1.5 %	3.2 %	1.5 %	3.2 %
International provision <sup>(1)</sup>	8.5 %	2.9 %	7.8 %	3.7 %
Permanent items	(0.5 )%	0.3 %	(0.1 )%	0.4 %
Other <sup>(2)</sup>	(1.0 )%	0.1 %	(1.1 )%	0.5 %
Effective rate	29.5 %	41.5%	29.1 %	42.8%

(1) Relates primarily to the lower tax rates attributable to international operations, and the impact of valuation allowances recorded on foreign loss jurisdictions.

(2) Includes impact of discrete items.

In accordance with the authoritative guidance for income taxes, each interim period is considered an integral part of the annual period and tax expense or benefit is measured using an estimated annual effective income tax rate. The estimated annual effective tax rate for the full year is applied to the respective interim period, taking into account

year-to-date amounts and projected amounts for the year. Since the Company operates in foreign countries with varying tax rates, the magnitude of the impact of the results the international operations has on the Company's quarterly effective tax rate is dependent on the level of income or loss from the international operations in the period.

## Table of Contents

The Company's subsidiary in Costa Rica is operating under a 100% tax holiday through December 31, 2026 and a 50% tax holiday for the subsequent four years. The impact of the tax holiday in Costa Rica for the three and six months ended June 30, 2018 and 2017, was immaterial.

The Company had gross unrecognized tax benefits, inclusive of penalties and interest, of \$21.7 million at June 30, 2018. These unrecognized tax benefits, if recognized, would result in a net tax benefit of \$10.0 million as of June 30, 2018. The gross unrecognized tax benefits did not materially change from December 31, 2017.

Of the \$181.7 million of cash and cash equivalents as of June 30, 2018, \$150.6 million was held outside of the United States. Following the enactment of the Tax Reform Act and the associated transition tax, in general, repatriation of cash to the United States can be completed with no incremental U.S. tax. However, repatriation of cash could subject the Company to non-U.S. jurisdictional taxes on distributions. The Company maintains non-U.S. funds in its foreign operations to (i) provide adequate working capital, (ii) satisfy various regulatory requirements, and (iii) take advantage of business expansion opportunities as they arise. The non-U.S. jurisdictional taxes applicable to foreign earnings are not readily determinable or practicable. The Company continues to evaluate the impact of the Tax Reform Act on its election to indefinitely reinvest certain of its non-U.S. earnings. As of June 30, 2018, management believes that it has sufficient liquidity to satisfy its cash needs, including its cash needs in the United States.

### Note 11: Commitments and Contingencies

#### Litigation and Regulatory

The Company is involved in disputes, legal actions, regulatory investigations, inquiries, and other actions from time to time in the ordinary course of business. The Company, along with others in its industry, is routinely subject to legal actions based on the Fair Debt Collection Practices Act ("FDCPA"), comparable state statutes, the Telephone Consumer Protection Act ("TCPA"), state and federal unfair competition statutes, and common law causes of action. The violations of law investigated or alleged in these actions often include claims that the Company lacks specified licenses to conduct its business, attempts to collect debts on which the statute of limitations has run, has made inaccurate or unsupported assertions of fact in support of its collection actions and/or has acted improperly in connection with its efforts to contact consumers. Such litigation and regulatory actions could involve potential compensatory or punitive damage claims, fines, sanctions, injunctive relief, or changes in business practices. Many continue on for some length of time and involve substantial investigation, litigation, negotiation, and other expense and effort before a result is achieved, and during the process the Company often cannot determine the substance or timing of any eventual outcome.

At June 30, 2018, there were no material developments in any of the legal proceedings disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

In certain legal proceedings, the Company may have recourse to insurance or third party contractual indemnities to cover all or portions of its litigation expenses, judgments, or settlements. In accordance with authoritative guidance, the Company records loss contingencies in its financial statements only for matters in which losses are probable and can be reasonably estimated. Where a range of loss can be reasonably estimated with no best estimate in the range, the Company records the minimum estimated liability. The Company continuously assesses the potential liability related to its pending litigation and regulatory matters and revises its estimates when additional information becomes available. As of June 30, 2018, other than the reserves related to the Consumer Finance Protection Bureau ("CFPB") Consent Order and ancillary state regulatory matters, the Company has no material reserves for legal matters. Additionally, based on the current status of litigation and regulatory matters, either the estimate of exposure is immaterial to the Company's financial statements or an estimate cannot yet be determined. The Company's legal costs are recorded to expense as incurred.

#### 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, 2018, the Company has entered into agreements to purchase receivable portfolios with a face value of approximately \$1.6 billion for a purchase price of approximately \$297.0 million. Most purchase commitments do not extend past one year.

### Note 12: Segment and Geographic Information



The Company conducts business through several operating segments that have similar economic and other qualitative characteristics and have been aggregated in accordance with authoritative guidance into one reportable segment, portfolio purchasing and recovery. Since the Company operates in one reportable segment, all required segment information can be found in the consolidated financial statements.

Table of Contents

The Company has operations in the United States, Europe and other foreign countries. The following table presents the Company's total revenues, adjusted by net allowances by geographic areas in which the Company operates (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Revenues, adjusted by net allowances <sup>(1)</sup> :				
United States	\$ 179,843	\$ 173,613	\$ 351,787	\$ 343,929
International				
Europe <sup>(2)</sup>	144,462	94,754	275,076	172,692
Other geographies	25,442	22,550	49,672	46,237
	169,904	117,304	324,748	218,929
Total	\$ 349,747	\$ 290,917	\$ 676,535	\$ 562,858

(1) Revenues, adjusted by net allowances, are attributed to countries based on location of customer. Revenues primarily include portfolio revenues and fee-based income earned on accounts collected on behalf of others.

(2) Based on the financial information that is used to produce the general-purpose financial statements, providing further geographic information is impracticable.

#### Note 13: Goodwill and Identifiable Intangible Assets

In accordance with authoritative guidance, goodwill is tested for impairment at the reporting unit level annually and in interim periods if certain events occur that indicate that the fair value of a reporting unit may be below its carrying value. Determining the number of reporting units and the fair value of a reporting unit requires the Company to make judgments and involves the use of significant estimates and assumptions.

The annual goodwill testing date for the reporting units that are included in the portfolio purchasing and recovery reportable segment is October 1st. There have been no events or circumstances during the six months ended June 30, 2018 that have required the Company to perform an interim assessment of goodwill carried at these reporting units. Management continues to evaluate and monitor all key factors impacting the carrying value of the Company's recorded goodwill and long-lived assets. Adverse changes in the Company's actual or expected operating results, market capitalization, business climate, economic factors or other negative events that may be outside the control of management could result in a material non-cash impairment charge in the future.

The Company's goodwill is attributable to reporting units included in its portfolio purchasing and recovery segment. The following table summarizes the activity in the Company's goodwill balance (in thousands):

	Total
Balance, December 31, 2017	\$928,993
Goodwill adjustments	(2,212 )
Effect of foreign currency translation	(17,718 )
Balance, June 30, 2018	\$909,063

The Company's acquired intangible assets are summarized as follows (in thousands):

	As of June 30, 2018			As of December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	\$73,032	\$ (10,240 )	\$ 62,792	\$73,875	\$ (6,800 )	\$ 67,075
Developed technologies	6,458	(5,818 )	640	6,683	(5,411 )	1,272
Trade name and other	10,789	(7,035 )	3,754	14,413	(7,024 )	7,389
Total intangible assets	\$90,279	\$ (23,093 )	\$ 67,186	\$94,971	\$ (19,235 )	\$ 75,736



Table of Contents

Note 14: Guarantee of Subsidiary Debt

Unless otherwise indicated in connection with a particular offering of debt securities, Encore will fully and unconditionally guarantee any debt securities issued by Encore Capital Europe Finance Limited (“Encore Finance”), a 100% owned finance subsidiary of Encore. Amounts related to Encore Finance are included in the consolidated financial statements of Encore subsequent to April 30, 2018, the date of the incorporation of Encore Finance. On July 20, 2018, Encore Finance issued \$172.5 million aggregate principal amount of exchangeable senior notes due 2023 (the “2023 Notes”), the 2023 Notes are fully and unconditionally guaranteed by Encore. Refer to Note 15, “Subsequent Events,” for further details of the 2023 Notes.

Note 15: Subsequent Events

The Cabot Transaction

On July 24, 2018, the Company completed the acquisitions contemplated by (i) the Securities Purchase Agreement dated May 7, 2018 (the “JCF SPA”) with JCF III Europe Holdings LP, JCF III Europe S.à r.l. (JCF III Europe Holdings LP and JCF III Europe S.à r.l. collectively referred to as “JCF Sellers”), Janus Holdings, and the other parties named therein, pursuant to which Encore indirectly acquired from the JCF Sellers all of the equity interests owned by the JCF Sellers in Janus Holdings and Cabot Holdings S.à r.l. Luxembourg (“Cabot Holdings”), resulting in Janus Holdings becoming a wholly owned subsidiary of Encore, and (ii) the Securities Purchase Agreement dated May 7, 2018 (the “Management SPA” and, together with the JCF SPA, the “Purchase Agreements”) with certain management shareholders of Cabot Holdings and such holders, together with all other management holders that signed a joinder to the Management SPA, the “Management Sellers”, pursuant to which Encore indirectly acquired from the Management Sellers all of the equity interests in Cabot Holdings owned by the Management Sellers, resulting in Cabot Holdings becoming a wholly owned subsidiary of Encore (collectively, the “Cabot Transaction”). The Cabot Transaction is an equity transaction in accordance with authoritative guidance, therefore, no purchase accounting adjustments are made. The difference between the carrying value of the noncontrolling interest and the fair value of total consideration for the Cabot Transaction is recorded as adjustment in equity.

The aggregate purchase price for the acquisition of the outstanding equity interests in Janus Holdings and Cabot Holdings not already owned by Encore was comprised of £178.5 million (approximately \$234.1 million) and 4,906,482 shares of Encore’s common stock, par value \$0.01 per share.

Exchangeable Senior Notes due 2023

On July 20, 2018, Encore Finance issued \$172.5 million aggregate principal amount of 2023 Notes. The 2023 Notes mature on September 1, 2023 and bear interest at a rate of 4.5% per year, payable semiannually in arrears on March 1 and September 1 of each year, beginning on March 1, 2019. Encore Finance may satisfy its exchange obligation by paying or delivering, as the case may be, cash, shares of Encore’s common stock or a combination of cash and shares of Encore’s common stock, at Encore Finance’s election, subject to certain restrictions. The exchange rate for the notes is initially 22.4090 shares of Encore’s common stock per \$1,000 principal amount of notes (equivalent to an initial exchange price of approximately \$44.62 per share of Encore’s common stock), subject to adjustment.

In connection with the issuance of the 2023 Notes, Encore entered into privately negotiated capped call transactions with certain option counterparties that effectively increased the exchange price to approximately \$62.48 per share. The cost of the capped call option was approximately \$17.8 million.

Cabot 2023 Notes

On July 18, 2018, Cabot Financial completed an exchange offer whereby certain holders of the outstanding £100.0 million Cabot 2020 Notes and holders of the outstanding £175.0 million Cabot 2021 Notes (together, the “Existing Notes”) exchanged their Existing Notes for Cabot 2023 Notes (the “Exchange Notes”). Pursuant to the exchange offer, Cabot Financial exchanged £32.2 million in aggregate principal amount of the Cabot 2020 Notes and £95.0 million in aggregate principal amount of the Cabot 2021 Notes, for a total of £128.4 million Exchange Notes. The Exchange Notes were issued as additional notes under the indenture entered into by Cabot Financial, among others, dated October 6, 2016, governing the Cabot 2023 Notes (the “Cabot 2023 Indenture”).

On the same day but in a separate transaction, Cabot Financial also issued £34.5 million of 7.500% additional notes (the “Additional Notes”) under the Cabot 2023 Indenture at 99.0% plus accrued interest from and including April 1, 2018.

Both the Exchange Notes and the Additional Notes are part of the same series as the currently outstanding £350.0 million 7.500% Cabot 2023 Notes issued under the Cabot 2023 Indenture.

30

---

Table of Contents

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

This Quarterly Report on Form 10-Q contains “forward-looking statements” relating to Encore Capital Group, Inc. (“Encore”) and its subsidiaries (which we may collectively refer to as the “Company,” “we,” “our” or “us”) within the meaning of the securities laws. The words “believe,” “expect,” “anticipate,” “estimate,” “project,” “intend,” “plan,” “will,” “may,” and similar expressions often characterize forward-looking statements. These statements may include, but are not limited to, projections of collections, revenues, income or loss, estimates of capital expenditures, plans for future operations, products or services and financing needs or plans, as well as assumptions relating to these matters. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we caution that these expectations or predictions may not prove to be correct or we may not achieve the financial results, savings, or other benefits anticipated in the forward-looking statements. These forward-looking statements are necessarily estimates reflecting the best judgment of our senior management and involve a number of risks and uncertainties, some of which may be beyond our control or cannot be predicted or quantified, that could cause actual results to differ materially from those suggested by the forward-looking statements. Many factors including, but not limited to, those set forth in our Annual Report on Form 10-K under “Part I, Item 1A. Risk Factors,” could cause our actual results, performance, achievements, or industry results to be very different from the results, performance, achievements or industry results expressed or implied by these forward-looking statements. Our business, financial condition, or results of operations could also be materially and adversely affected by other factors besides those listed. Forward-looking statements speak only as of the date the statements were made. We do not undertake any obligation to update or revise any forward-looking statements to reflect new information or future events, or for any other reason, even if experience or future events make it clear that any expected results expressed or implied by these forward-looking statements will not be realized. In addition, it is generally our policy not to make any specific projections as to future earnings, and we do not endorse projections regarding future performance that may be made by third parties.

**Our Business**

We are an international specialty finance company providing debt recovery solutions and other related services for consumers across a broad range of financial assets. We purchase portfolios of defaulted consumer receivables at deep discounts to face value and manage them by working with individuals as they repay their obligations and work toward financial recovery. Defaulted receivables are consumers’ unpaid financial commitments to credit originators, including banks, credit unions, consumer finance companies, commercial retailers, and telecommunication companies.

Defaulted receivables may also include receivables subject to bankruptcy proceedings.

**United States**

We are a market leader in portfolio purchasing and recovery in the United States, including Puerto Rico.

**Europe**

Cabot Credit Management plc (together with its subsidiaries, “Cabot”), our largest international subsidiary, is one of the largest credit management services providers in Europe and is a market leader in the United Kingdom and Ireland.

Cabot, in addition to its primary business of portfolio purchasing and recovery, also provides a range of debt servicing offerings such as early stage collections, business process outsourcing (“BPO”), contingent collections, trace services and litigation activities. Cabot strengthened its debt servicing offerings with the acquisition of Wescot Credit Services Limited (“Wescot”), a leading U.K. contingency debt collection and BPO services company in November 2017.

Previously we controlled Cabot via our majority ownership interest in the indirect holding company of Cabot, Janus Holdings Luxembourg S.à r.l. (“Janus Holdings”). On July 24, 2018, we completed the purchase of all of the outstanding equity of Cabot not owned by us (the “Cabot Transaction”). As a result, Cabot became a wholly owned subsidiary of Encore.

In addition, we have certain subsidiaries that primarily focus on (a) consumer non-performing loans, including insolvencies (in particular, individual voluntary arrangements, or “IVAs”) in the United Kingdom and bank and non-bank receivables in Spain and (b) credit management services in Spain (collectively, “Grove”).

**Latin America**

Our majority-owned subsidiary, Refinancia S.A.S. (together with its subsidiaries, “Refinancia”), is a market leader in debt collection and management in Colombia and Peru. In addition to purchasing defaulted receivables, Refinancia

offers portfolio management services to banks for non-performing loans. Refinancia also specializes in non-traditional niches in the geographic areas in which it operates, including point-of-purchase lending to consumers and providing financial solutions to individuals who have previously defaulted on their credit obligations.

## Table of Contents

In addition to operations in Colombia and Peru, we evaluate and purchase non-performing loans in other countries in Latin America, including Mexico and Brazil. We also invest in non-performing secured residential mortgages in Latin America.

### Asia Pacific

Our subsidiary, Baycorp Holdings Pty Limited (together with its subsidiaries, “Baycorp”), specializes in the management of non-performing loans in Australia and New Zealand. In addition to purchasing defaulted receivables, Baycorp offers portfolio management services to banks for non-performing loans. We acquired a majority ownership interest in Baycorp in October 2015 and acquired the remaining minority equity ownership interest in Baycorp in January 2018.

In India, we invested in Encore Asset Reconstruction Company Private Limited (“EARC”), which has completed initial immaterial purchases.

To date, operating results from our international operations on an individual basis, other than from Cabot, have not been significant to our total consolidated operating results. Our long-term growth strategy involves continuing to invest in our core portfolio purchasing and recovery business, strengthening and developing our international businesses, and leveraging our core competencies to explore expansion into adjacent asset classes.

### Government Regulation

#### United States

As discussed in more detail under “Part I - Item 1 - Business - Government Regulation” contained in our Annual Report on Form 10-K, our U.S. debt purchasing business and collection activities are subject to federal, state and municipal statutes, rules, regulations and ordinances that establish specific guidelines and procedures that debt purchasers and collectors must follow when collecting consumer accounts, including among others, specific guidelines and procedures for communicating with consumers and prohibitions on unfair, deceptive or abusive debt collection practices.

#### International

As discussed in more detail under “Part I - Item 1 - Business - Government Regulation” contained in our Annual Report on Form 10-K, our international operations are affected by foreign statutes, rules and regulations regarding debt collection and debt purchase activities. These statutes, rules, regulations, ordinances, guidelines and procedures are modified from time to time by the relevant authorities charged with their administration, which could affect the way we conduct our business.

The Financial Conduct Authority (“FCA”) have now confirmed that the UK Senior Managers and Certification Regime (“SMCR”) will be extended to all sectors of the financial services industry (including consumer credit firms), at which point the majority of Cabot Credit Management Group Limited’s (“CCMG”) senior management team below the executive committee is expected to become certified persons, which could result in additional costs for CCMG. The objective of the regulation is to raise standards of conduct in financial services and to hold senior individuals accountable. The final implementation date for SMCR is December 9, 2019.

The Consumer Credit Act of 1974 (and its related regulations) and the U.K. Consumer Rights Act 2015 set forth requirements for the entry into and ongoing management of consumer credit arrangements in the United Kingdom. A failure to comply with these requirements can make agreements unenforceable or can result in a requirement that charged and collected interest be repaid. The FCA is in the process of reviewing the provisions of the Consumer Credit Act 1974, with a view to consider implementing rules into its handbook to replace the legislation. The FCA is expected to issue its final report by April 2019.

Cabot must comply with requirements established by the Data Protection Act of 2018 in relation to processing the personal data of its consumers. This legislation came into effect on May 23, 2018 to implement the EU General Data Protection Regulation (“GDPR”). This substantially replaced the Data Protection Act of 1998 and introduced significant changes to the data protection regime including but not limited to: the conditions for obtaining consent to process personal data; transparency and providing information to individuals regarding the processing of their personal data; enhanced rights for individuals; notification obligations for personal data breach; and new supervisory authorities, including a European Data Protection Board (“EDPB”). CCMG has made the required changes in its UK operations across its debt purchasing and servicing businesses to meet the requirements of the GDPR and the Data Protection Act



2018. A Data Protection Officer has been appointed and is supported at each UK site to promote and enforce good data protection practices.

## Table of Contents

### Portfolio Purchasing and Recovery

#### United States

We purchase receivables based on robust, account-level valuation methods and employ proprietary statistical and behavioral models across our U.S. operations. These methods and models allow us to value portfolios accurately (and limit the risk of overpaying), avoid buying portfolios that are incompatible with our methods or strategies and align the accounts we purchase with our business channels to maximize future collections. As a result, we have been able to realize significant returns from the receivables we acquire. We maintain strong relationships with many of the largest financial service providers in the United States.

While seasonality does not have a material impact on our business, collections are generally strongest in our first calendar quarter, slower in the second and third calendar quarters, and slowest in the fourth calendar quarter.

Relatively higher collections in the first quarter could result in a lower cost-to-collect ratio compared to the other quarters, as our fixed costs are relatively constant and applied against a larger collection base. The seasonal impact on our business may also be influenced by our purchasing levels, the types of portfolios we purchase, and our operating strategies.

Collection seasonality can also affect revenue as a percentage of collections, also referred to as our revenue recognition rate. Generally, revenue for each pool group declines steadily over time, whereas collections can fluctuate from quarter to quarter based on seasonality, as described above. In quarters with lower collections (e.g., the fourth calendar quarter), the revenue recognition rate can be higher than in quarters with higher collections (e.g., the first calendar quarter).

In addition, seasonality could have an impact on the relative level of quarterly earnings. In quarters with stronger collections, total costs are higher as a result of the additional efforts required to generate those collections. Since revenue for each pool group declines steadily over time, in quarters with higher collections and higher costs (e.g., the first calendar quarter), all else being equal, earnings could be lower than in quarters with lower collections and lower costs (e.g., the fourth calendar quarter). Additionally, in quarters where a greater percentage of collections come from our legal and agency outsourcing channels, cost to collect will be higher than if there were more collections from our internal collection sites.

#### International

Through Cabot, we purchase paying and non-paying receivable portfolios using a proprietary pricing model that utilizes account-level statistical and behavioral data. This model allows Cabot to value portfolios with a high degree of accuracy and quantify portfolio performance in order to maximize future collections. As a result, Cabot has been able to realize significant returns from the assets it has acquired. Cabot maintains strong relationships with many of the largest financial services providers in the United Kingdom and continues to expand in the United Kingdom and the rest of Europe with its acquisitions of portfolios and other credit management services providers.

While seasonality does not have a material impact on Cabot's operations, collections are generally strongest in the second and third calendar quarters and slower in the first and fourth quarters, largely driven by the impact of the December holiday season and the New Year holiday, and the related impact on its customers' ability to repay their balances. This drives a higher level of plan defaults over this period, which are typically repaired across the first quarter of the following year. The August vacation season in the United Kingdom also has an unfavorable effect on the level of collections, but this is traditionally compensated for by higher collections in July and September.

### Purchases and Collections

#### Portfolio Pricing, Supply and Demand

##### United States

Industry delinquency and charge-off rates, which had been at historic lows, have continued to increase, creating higher volumes of charged-off accounts that are sold. In addition, issuers have continued to increase the amount of fresh portfolios in their sales. Fresh portfolios are portfolios that are generally sold within six months of the consumer's account being charged-off by the financial institution. Meanwhile, prices for portfolios offered for sale started to decrease after several years of elevated pricing, especially for fresh portfolios. We believe the softening in pricing, especially for fresh portfolios, was primarily due to this growth, and anticipated future growth, in supply. In addition to selling a higher volume of charged-off accounts, issuers continued to sell their volume earlier in the calendar year

than they had in the past.

We believe that smaller competitors continue to face difficulties in the portfolio purchasing market because of the high cost to operate due to regulatory pressure and because issuers are being more selective with buyers in the marketplace, resulting

33

---

Table of Contents

in consolidation within the portfolio purchasing and recovery industry. We believe this favors larger participants, such as Encore, because the larger market participants are better able to adapt to these pressures.

**International**

The U.K. market for charged-off portfolios has grown significantly in recent years driven by a consolidation of sellers and a material backlog of portfolio coming to market from credit issuers who are selling an increasing proportion of their non-performing loans. Prices for portfolios offered for sale directly from credit issuers remain at levels higher than historical averages. We expect that as a result of an increase in available funding to industry participants, and lower return requirements for certain debt purchasers, pricing will remain elevated. However, we believe that with our competitive advantages, we will continue to be able to generate strong risk adjusted returns in the U.K. market.

The U.K. insolvency market as a whole has remained flat over the past twelve months, although we are seeing an increase in new IVAs. We believe this is driven by continued consolidation of the IVA market with a resultant focus on steering consumers in financial difficulty into IVAs. We expect that this trend will drive increased purchasing opportunities at the point large retail banks sell their insolvency portfolios.

The Spanish debt market continues to be one of the largest in Europe with a significant amount of debt to be sold and serviced. In particular, we anticipate strong debt purchasing and servicing opportunities in the secured and small and medium enterprise asset classes given the backlog of non-performing debt that has accumulated in these sectors.

Additionally, financial institutions continue to experience both market and regulatory pressure to dispose of non-performing loans which should further increase debt purchasing opportunities in Spain.

Although pricing has been elevated, we believe that as our European businesses increase in scale and expand to other markets, and with anticipated improvements in liquidation and improved efficiencies in collections, our margins will remain competitive. Additionally, Cabot's continuing investment in its litigation liquidation channel has enabled them to collect from consumers who have the ability to pay, but have so far been unwilling to do so. This enables Cabot to mitigate some of the impact of elevated pricing.

**Purchases by Type and Geographic Location**

The following table summarizes the types and geographic locations of consumer receivable portfolios we purchased during the periods presented (in thousands):

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2018	2017	2018	2017
United States:				
Credit card	\$188,766	\$121,297	\$354,956	\$234,023
Other	13,746	10,985	26,594	21,137
Subtotal	202,512	132,282	\$381,550	\$255,160
Europe:				
Credit card	145,648	90,696	214,045	175,809
Other	1,364	1,561	20,282	1,561
Subtotal	147,012	92,257	234,327	177,370
Other geographies:				
Credit card	8,884	17,964	19,293	27,964
Other	1,172	3,912	1,172	4,648
Subtotal	10,056	21,876	20,465	32,612
Total purchases	\$359,580	\$246,415	\$636,342	\$465,142

During the three months ended June 30, 2018, we invested \$359.6 million to acquire consumer receivable portfolios, with face values aggregating \$2.9 billion, for an average purchase price of 12.5% of face value. This is a \$113.2 million, or 45.9%, increase in the amount invested, compared with the \$246.4 million invested during the three months ended June 30, 2017, to acquire consumer receivable portfolios with face values aggregating \$2.4 billion, for an average purchase price of 10.1% of face value.



Table of Contents

During the six months ended June 30, 2018, we invested \$636.3 million to acquire consumer receivable portfolios, with face values aggregating \$4.7 billion, for an average purchase price of 13.6% of face value. This is a \$171.2 million, or 36.8%, increase in the amount invested, compared with the \$465.1 million invested during the six months ended June 30, 2017, to acquire consumer receivable portfolios with face values aggregating \$4.1 billion, for an average purchase price of 11.3% of face value.

In the United States, capital deployment increased for the three and six months ended June 30, 2018, as compared to the corresponding periods in the prior year. The increases were primarily driven by continued growth in the supply of fresh portfolios. We have been successful in securing larger volume of fresh portfolios with improved expected returns.

In Europe, capital deployment for the three and six months ended June 30, 2018 increased as compared to the corresponding periods in the prior year. The increases were primarily driven by our continued strategic expansion in the European debt purchasing market and the favorable impact from foreign currency translation, due to the weakening of the U.S. dollar against the British Pound and Euro.

The average purchase price, as a percentage of face value, varies from period to period depending on, among other factors, the quality of the accounts purchased and the length of time from charge-off to the time we purchase the portfolios.

**Collections by Channel and Geographic Location**

We currently utilize three channels for the collection of our receivables: collection sites, legal collections, and collection agencies. The collection sites channel consists of collections that result from our call centers, direct mail program and online collections. The legal collections channel consists of collections that result from our internal legal channel or from our network of retained law firms. The collection agencies channel consists of collections from third-party collection agencies that we utilize when we believe they can liquidate better or less expensively than we can or to supplement capacity in our internal call centers. The collection agencies channel also includes collections on accounts purchased where we maintain the collection agency servicing until the accounts can be recalled and placed in our collection channels. The following table summarizes the total collections by collection channel and geographic area (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
<b>United States:</b>				
Collection sites	\$156,146	\$128,351	\$310,113	\$260,069
Legal collections	140,955	145,009	273,597	287,973
Collection agencies	13,704	13,105	26,062	25,898
Subtotal	310,805	286,465	609,772	573,940
<b>Europe:</b>				
Collection sites	76,793	72,171	158,804	150,199
Legal collections	35,867	32,247	67,247	61,513
Collection agencies	44,273	28,270	93,059	46,934
Subtotal	156,933	132,688	319,110	258,646
<b>Other geographies:</b>				
Collection sites	22,259	21,313	44,430	42,435
Legal collections	2,304	1,865	4,411	3,649
Collection agencies	3,792	3,851	7,472	8,375
Subtotal	28,355	27,029	56,313	54,459
<b>Total collections</b>	<b>\$496,093</b>	<b>\$446,182</b>	<b>\$985,195</b>	<b>\$887,045</b>

Gross collections increased by \$49.9 million, or 11.2%, to \$496.1 million during the three months ended June 30, 2018, from \$446.2 million during the three months ended June 30, 2017. Gross collections increased by \$98.2 million, or 11.1%, to \$985.2 million during the six months ended June 30, 2018, from \$887.0 million during the six months

ended June 30, 2017.

The increases of collections in the United States were primarily due to the acquisition of portfolios with higher returns in recent periods, the increase in our collection capacity, and our continued effort in improving liquidation. The increases in collections in Europe were primarily the result of increased purchasing volume and implementing certain liquidation

35

---

Table of Contents

improvement initiatives and the favorable impact of foreign currency translation, which was primarily the result of the weakening of the U.S. dollar against the British Pound.

## Results of Operations

Results of operations, in dollars and as a percentage of total revenues, adjusted by net allowances, were as follows (in thousands, except percentages):

	Three Months Ended June 30,					
	2018		2017			
Revenues						
Revenue from receivable portfolios	\$292,662	83.7 %	\$263,407	90.5 %		
Other revenues	39,453	11.3 %	18,681	6.5 %		
Total revenues	332,115	95.0 %	282,088	97.0 %		
Allowance reversals on receivable portfolios, net	17,632	5.0 %	8,829	3.0 %		
Total revenues, adjusted by net allowances	349,747	100.0 %	290,917	100.0 %		
Operating expenses						
Salaries and employee benefits	90,960	26.0 %	75,786	26.1 %		
Cost of legal collections	51,255	14.7 %	53,409	18.3 %		
Other operating expenses	39,039	11.2 %	24,030	8.2 %		
Collection agency commissions	12,151	3.5 %	11,494	4.0 %		
General and administrative expenses	41,986	12.0 %	36,932	12.7 %		