ENCORE CAPITAL GROUP INC
Form 10-Q
November 05, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2015
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 incorporation or organization)	(IRS Employer Identification No.)
3111 Camino Del Rio North, Suite 103 San Diego, California	92108
(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 x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 29, 2015
Common Stock, $0.01 par value	25,273,825 shares

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PART I – FINANCIAL INFORMATION
Item 1—Condensed Consolidated Financial Statements (Unaudited)
ENCORE CAPITAL GROUP, INC.
Condensed Consolidated Statements of Financial Condition
(In Thousands, Except Par Value Amounts)
(Unaudited)

	September 30, 2015	December 31, 2014
Assets		
Cash and cash equivalents	$175,220	$124,163
Investment in receivable portfolios, net	2,323,224	2,143,560
Receivables secured by property tax liens, net	297,592	259,432
Property and equipment, net	63,042	66,969
Deferred court costs, net	74,054	60,412
Other assets	229,697	197,666
Goodwill	940,181	897,933
Total assets	$4,103,010	$3,750,135
Liabilities and equity		
Liabilities:		
Accounts payable and accrued liabilities	$239,151	$231,967
Debt	3,116,444	2,773,554
Other liabilities	87,735	79,675
Total liabilities	3,443,330	3,085,196
Commitments and contingencies		
Redeemable noncontrolling interest	26,934	28,885
Redeemable equity component of convertible senior notes	6,881	9,073
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, 25,274 shares and 25,794 shares issued and outstanding as of September 30, 2015 and December 31, 2014, respectively	253	258
Additional paid-in capital	106,454	125,310
Accumulated earnings	544,477	498,354
Accumulated other comprehensive loss	(29,279)	(922)
Total Encore Capital Group, Inc. stockholders' equity	621,905	623,000
Noncontrolling interest	3,960	3,981
Total equity	625,865	626,981
Total liabilities, redeemable equity and equity	$4,103,010	$3,750,135

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 11, "Variable Interest Entities" for additional information on the Company's VIEs.

	September 30, 2015	December 31, 2014
Assets		
Cash and cash equivalents	$69,463	$44,996
Investment in receivable portfolios, net	1,194,341	993,462
Receivables secured by property tax liens, net	88,206	108,535

Property and equipment, net	18,524	15,957
Deferred court costs, net	32,244	17,317
Other assets	43,733	80,264
Goodwill	715,877	671,434
Liabilities		
Accounts payable and accrued liabilities	$105,904	$137,201
Debt	1,773,831	1,556,956
Other liabilities	21,411	8,724

See accompanying notes to condensed consolidated financial statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues				
Revenue from receivable portfolios, net	$265,523	$251,785	$799,934	$737,584
Other revenues	14,558	13,445	42,080	38,943
Net interest income	7,715	8,052	21,801	19,691
Total revenues	287,796	273,282	863,815	796,218
Operating expenses				
Salaries and employee benefits	64,976	61,175	200,269	183,667
Cost of legal collections	58,760	53,742	170,834	153,596
Other operating expenses	23,953	22,061	72,202	72,196
Collection agency commissions	9,381	9,517	28,532	25,275
General and administrative expenses	88,002	35,532	159,780	110,508
Depreciation and amortization	8,235	6,933	24,669	19,879
Total operating expenses	253,307	188,960	656,286	565,121
Income from operations	34,489	84,322	207,529	231,097
Other (expense) income				
Interest expense	(47,816)	(43,498)	(136,369)	(124,678)
Other (expense) income	(924)	(532)	1,588	(192)
Total other expense	(48,740)	(44,030)	(134,781)	(124,870)
(Loss) income before income taxes	(14,251)	40,292	72,748	106,227
Benefit (provision) for income taxes	4,887	(10,154)	(26,960)	(35,906)
Net (loss) income	(9,364)	30,138	45,788	70,321
Net (income) loss attributable to noncontrolling interest	(1,595)	197	335	6,755
Net (loss) income attributable to Encore Capital Group, Inc. stockholders	$(10,959)	$30,335	$46,123	$77,076
(Loss) earnings per share attributable to Encore Capital Group, Inc.:				
Basic	$(0.43)	$1.17	$1.79	$2.99
Diluted	$(0.43)	$1.11	$1.71	$2.79
Weighted average shares outstanding:				
Basic	25,450	25,879	25,800	25,811
Diluted	25,450	27,332	26,912	27,622

See accompanying notes to condensed consolidated financial statements

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ENCORE CAPITAL GROUP, INC.
Condensed Consolidated Statements of Comprehensive (Loss) Income
(Unaudited, In Thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net (loss) income	$(9,364)	$30,138	$45,788	$70,321
Other comprehensive (loss) income, net of tax:				
Unrealized (loss) income on derivative instruments	(373)	(134)	(24)	2,095
Unrealized loss on foreign currency translation	(14,110)	(7,529)	(28,333)	(4,016)
Other comprehensive loss, net of tax	(14,483)	(7,663)	(28,357)	(1,921)
Comprehensive (loss) income	(23,847)	22,475	17,431	68,400
Comprehensive loss (income) attributable to noncontrolling interest:				
Net (income) loss	(1,595)	197	335	6,755
Unrealized loss on foreign currency translation	2,308	1,372	3,196	902
Comprehensive loss attributable to noncontrolling interests	713	1,569	3,531	7,657
Comprehensive (loss) income attributable to Encore Capital Group, Inc. stockholders	$(23,134)	$24,044	$20,962	$76,057

See accompanying notes to condensed consolidated financial statements

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

	Nine Months Ended September 30,	
	2015	2014
Operating activities:		
Net income	$45,788	$70,321
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	24,669	19,879
Non-cash interest expense, net	27,455	20,989
Stock-based compensation expense	17,259	13,560
Deferred income taxes	(257)	(11,863)
Excess tax benefit from stock-based payment arrangements	(1,705)	(11,422)
Reversal of allowances on receivable portfolios, net	(3,958)	(12,455)
Changes in operating assets and liabilities		
Deferred court costs and other assets	(41,354)	(16,498)
Prepaid income tax and income taxes payable	(45,776)	2,402
Accounts payable, accrued liabilities and other liabilities	41,260	23,850
Net cash provided by operating activities	63,381	98,763
Investing activities:		
Cash paid for acquisitions, net of cash acquired	(236,214)	(495,519)
Purchases of receivable portfolios, net of put-backs	(549,957)	(666,470)
Collections applied to investment in receivable portfolios, net	488,174	488,086
Originations and purchases of receivables secured by tax liens	(167,739)	(108,739)
Collections applied to receivables secured by tax liens	123,407	93,986
Purchases of property and equipment	(15,754)	(13,598)
Other, net	3,178	(1,987)
Net cash used in investing activities	(354,905)	(704,241)
Financing activities:		
Payment of loan costs	(7,316)	(15,271)
Proceeds from credit facilities	903,319	993,449
Repayment of credit facilities	(466,745)	(878,883)
Proceeds from senior secured notes	—	288,645
Repayment of senior secured notes	(11,250)	(11,250)
Proceeds from issuance of convertible senior notes	—	161,000
Proceeds from issuance of securitized notes	—	134,000
Repayment of securitized notes	(32,324)	(20,599)
Repayment of preferred equity certificates, net	—	(702)
Purchases of convertible hedge instruments	—	(33,576)
Repurchase of common stock	(33,185)	(16,815)
Taxes paid related to net share settlement of equity awards	(6,050)	(19,356)
Excess tax benefit from stock-based payment arrangements	1,705	11,422
Other, net	(2,299)	987
Net cash provided by financing activities	345,855	593,051
Net increase in cash and cash equivalents	54,331	(12,427)
Effect of exchange rate changes on cash and cash equivalents	(3,274)	1,654
Cash and cash equivalents, beginning of period	124,163	126,213

Cash and cash equivalents, end of period	$175,220	$115,440
Supplemental disclosures of cash flow information:		
Cash paid for interest	$114,731	$120,125
Cash paid for income taxes, net	72,306	54,452
Supplemental schedule of non-cash investing and financing activities:		
Fixed assets acquired through capital lease	$1,290	$6,852

See accompanying notes to condensed consolidated financial statements

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ENCORE CAPITAL GROUP, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

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

Encore Capital Group, Inc. (“Encore”), through its subsidiaries (collectively with Encore, the “Company”), is an international specialty finance company providing debt recovery solutions for consumers and property owners 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. Encore, through certain subsidiaries, is a market leader in portfolio purchasing and recovery in the United States, including Puerto Rico. Encore’s subsidiary, Janus Holdings Luxembourg S.a.r.l. (“Janus Holdings”), through its indirectly held U.K.-based subsidiary Cabot Credit Management Limited and its subsidiaries (collectively, “Cabot”), is a market leader in credit management services in the United Kingdom, historically specializing in portfolios consisting of higher balance, semi-performing accounts. Cabot’s acquisition of Marlin Financial Group Limited (“Marlin”) in February 2014, provides Cabot with substantial litigation-enhanced collection capabilities for non-performing accounts, and Cabot continued to expand in the United Kingdom with its acquisition of Hillesden Securities Ltd and its subsidiaries (“dlc”) in June 2015. Encore’s majority-owned subsidiary, Grove Holdings (“Grove”), is a U.K.-based leading specialty investment firm focused on 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. Encore’s majority-owned subsidiary, Refinancia S.A. (“Refinancia”), through its subsidiaries, is a market leader in debt collection and management in Colombia and Peru. In addition, through Encore’s subsidiary, Propel Acquisition, LLC and its subsidiaries (collectively, “Propel”), the Company assists property owners who are delinquent on their property taxes by structuring affordable monthly payment plans and purchases delinquent tax liens directly from selected taxing authorities. In October 2015, the Company completed the acquisition of a controlling stake in Baycorp Holdings Pty Limited (“Baycorp”), one of Australasia's leading debt resolution specialists. The acquisition of Baycorp expands the Company’s operations into Australia and New Zealand and its global reach into 13 countries.

Portfolio Purchasing and Recovery

United States

The Company purchases receivable portfolios based on robust, account-level valuation methods and employs a suite of proprietary statistical and behavioral models across the full extent of its operations. These methods and models allow the Company to value portfolios accurately (and limit the risk of overpaying), avoid buying portfolios that are incompatible with its methods or goals and precisely align the accounts it purchases with its operational channels to maximize future collections. As a result, the Company has been able to realize significant returns from the receivables it acquires. The Company maintains strong relationships with many of the largest financial service providers in the United States.

The Company uses insights discovered during its purchasing process to build account collection strategies. The Company’s proprietary consumer-level collectability analysis is the primary determinant of whether an account will be actively serviced post-purchase. The Company continuously refines this analysis to determine the most effective collection strategy to pursue for each account it owns. After its preliminary analysis, the Company seeks to collect on only a fraction of the accounts it purchases, through one or more of its collection channels. The channel identification process is analogous to a funneling system, where the Company first differentiates those consumers who it believes are not able to pay from those who are able to pay. Consumers who the Company believes are financially incapable of making any payments, facing extenuating circumstances or hardships (such as medical issues), serving in the military, or currently receiving social security as their only source of income are excluded from the next step of its collection process and are designated as inactive. The remaining pool of accounts in the funnel then receives further evaluation. At that point, the Company analyzes and determines a consumer’s perceived willingness to pay. Based on that analysis, the Company will pursue collections through letters and/or phone calls to its consumers. Despite its efforts to reach consumers and work out a settlement option, only a small number of consumers who are contacted choose to engage with the Company. Those who do are often offered deep discounts on their obligations, or are presented with payment plans that are better suited to meet their daily cash flow needs. The majority of contacted consumers, however, do not respond to the Company's calls or letters, and therefore the Company must then make the difficult decision whether or not to pursue collections through legal means.

The Company continually monitors applicable changes to laws governing statutes of limitations and disclosures to consumers. The Company maintains policies, system controls, and processes designed to ensure that accounts past the applicable statute of limitations do not get placed into legal collections. Additionally, in written and verbal communications

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with consumers, the Company provides disclosures to the consumer that the account is past its applicable statute of limitations and, therefore, the Company will not pursue collections through legal means.

Europe

Cabot: Through Cabot, portfolio receivables are purchased using a proprietary pricing model. 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 service providers in the United Kingdom.

Cabot also uses insights discovered during its purchasing process to build account-level collection strategies. Cabot's proprietary consumer-level collectability analysis is a determinant of how an account will be serviced post-purchase. Cabot continuously refines this analysis to determine the most effective customer engagement strategy to pursue for each account it owns to ensure that customers are treated fairly and the most suitable engagement and collection strategy for each individual customer is deployed. Cabot has concentrated on buying high-balance financial services debt, both paying and non-paying. Cabot establishes contact with consumers, in order to convey payment arrangements and gauge the willingness of these consumers to continue to pay. Consumers who Cabot believes are financially incapable of making any payments, those having negative disposable income, or those experiencing hardships, are managed outside of normal collection routines.

The remaining pool of accounts then receives further evaluation. Cabot analyzes and estimates a consumer's perceived willingness to pay. Based on that analysis, Cabot tries to engage with customers through letters and/or phone calls. Where contact is made and consumers indicate a willingness to pay, a patient approach of forbearance is applied using regulatory protocols within the United Kingdom to assess affordability and ensure that plans are fair and balanced and therefore, sustainable. Where consumers cannot be located or refuse to engage in a constructive dialogue, Cabot will pass these accounts through a litigation scorecard and rule set in order to assess suitability for legal action. Through Cabot's Marlin subsidiary, Cabot has a competitive advantage in the use of litigation-enhanced collections for non-paying accounts.

Grove: Grove, through its subsidiaries and affiliates, is a leading specialty investment firm focused on consumer non-performing loans, including insolvencies (in particular, IVAs) in the United Kingdom and bank and non-bank receivables in Spain. Grove purchases portfolio receivables using a proprietary pricing model. This model allows Grove to value portfolios with a high degree of accuracy and quantify portfolio performance in order to maximize future collections.

Latin America

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 Colombia, including providing financial solutions to individuals who have previously defaulted on their credit obligations, payment plan guarantee and factoring services through merchants and loan guarantee services to financial institutions.

Beginning in December 2014 the Company began investing in non-performing secured residential mortgages in Latin America.

Tax Lien Business

Propel's principal business is the acquisition and servicing of tax liens on residential and commercial real property. These liens take priority over most other liens, including mortgage liens. By funding unpaid property taxes, Propel provides state and local taxing authorities and governments with much needed tax revenue. To the extent permitted by local law, Propel works directly with property owners to structure affordable payment plans designed to allow them to keep their property while paying their property tax obligation over time. In such cases, Propel pays their tax lien obligation to the taxing authority, and the property owner pays Propel at a lower interest rate or over a longer period of time than the taxing authority would ordinarily permit. Propel also purchases tax liens directly from taxing authorities in various states. In many cases, these tax liens continue to be serviced by the taxing authority. When the taxing authority receives payment for the outstanding taxes, it pays Propel the outstanding balance of the lien plus interest, which is established by statute, negotiated at the time of the purchase, or determined by the bid Propel submitted to acquire the tax lien. Propel maintains a foreclosure rate of less than 0.5%.

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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, 2014. 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 11, "Variable Interest Entities," for further details. All intercompany transactions and balances have been eliminated in consolidation.

On August 6, 2014, the Company acquired all of the outstanding equity interests of Atlantic Credit & Finance, Inc. (the "Atlantic Acquisition"), on February 7, 2014, Cabot completed the acquisition of Marlin ("the Marlin Acquisition") and on June 1, 2015, Cabot completed the acquisition of dlc (the "dlc Acquisition"). The condensed consolidated financial statements include the results of operations of subsidiaries from mergers and acquisitions, since the date of the respective acquisitions.

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

Reclassifications

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

Recent Accounting Pronouncements

In February 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-02, "Amendments to the Consolidation Analysis." This ASU affects reporting entities that are required to evaluate whether they should consolidate certain legal entities. Specifically, the amendments: (1) Modify the evaluation of whether limited partnerships and similar legal entities are VIEs or voting interest entities; (2) Eliminate the presumption that a general partner should consolidate a limited partnership; (3) Affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships; and (4) Provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in

Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. ASU No. 2015-02 is effective for interim and annual reporting periods beginning after December 15, 2015. This standard is not expected to have a significant impact to the Company's financial statements.

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In April 2015, the FASB issued ASU No. 2015-03, "Simplifying the Presentation of Debt Issuance Costs". This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This ASU is effective beginning January 1, 2016, with early adoption permitted, and shall be applied retrospectively. The Company is currently assessing the impact that adopting this new accounting guidance will have on its consolidated financial statements and footnotes disclosures.

In August 2015, the FASB issued ASU No. 2015-15, "Interest — Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements — Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting" ("ASU 2015-15"), which clarifies the treatment of debt issuance costs from line-of-credit arrangements after the adoption of ASU 2015-03. In particular, ASU 2015-15 clarifies that the SEC would not object to an entity deferring and presenting debt issuance costs related to a line-of-credit arrangement as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of such arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. ASU 2015-15 is effective immediately for both public business entities and non-public entities. The Company believes the adoption of ASU 2015-15 will not have a material effect on its consolidated financial statements.

In September 2015, the FASB issued ASU No. 2015-16, "Simplifying the Accounting for Measurement-Period Adjustments" ("ASU 2015-16"). ASU 2015-16 eliminates the requirement for an acquirer in a business combination to account for measurement-period adjustments retrospectively. ASU 2015-16 is effective for public business entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for any interim and annual financial statements that have not yet been issued. ASU 2015-16 is applied prospectively to adjustments to provisional amounts that occur after the effective date, i.e., ASU 2015-16 applies to open measurement periods, regardless of the acquisition date. The Company early adopted this standard in the third quarter of 2015. The adoption of this guidance did not have a material impact on its consolidated financial statements and footnotes disclosures.

Note 2: Earnings (Loss) 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. In computing the diluted net loss per share, dilutive potential common shares are excluded from the diluted loss per share calculation because of their anti-dilutive effect.

On April 24, 2014, the Company's Board of Directors approved a $50.0 million share repurchase program. In May 2014, the Company repurchased 400,000 shares of its common stock for approximately $16.8 million. In May 2015, the Company repurchased 839,295 shares of common stock for approximately $33.2 million, which represented the remaining amount allowed under the share repurchase program.

On August 12, 2015, the Company's Board of Directors approved a new $50.0 million share repurchase program. Repurchases under this program are expected to be made with cash on hand and may be made from time to time, subject to market conditions and other factors, in the open market, through private transactions, block transactions, or other methods as determined by the Company's management and Board of Directors, and in accordance with market conditions, other corporate considerations, and applicable regulatory requirements. The program does not obligate the Company to acquire any particular amount of common stock, and it may be modified or suspended at any time at the Company's discretion.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Weighted average common shares outstanding—basic	25,450	25,879	25,800	25,811

Dilutive effect of stock-based awards	—	410	265	684
Dilutive effect of convertible senior notes	—	1,043	847	1,118
Dilutive effect of warrants	—	—	—	9
Weighted average common shares outstanding—diluted	25,450	27,332	26,912	27,622

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Due to a one-time charge resulting from a settlement with the Consumer Finance Protection Bureau ("CFPB"), discussed in detail in Note 13, "Commitments and Contingencies," the Company incurred a net loss during the three months ended September 30, 2015, therefore the dilutive potential common shares are excluded from the diluted loss per share calculation during this period because of their anti-dilutive effect.

There were no anti-dilutive employee stock options outstanding during the nine months ended September 30, 2015 or the three and nine months ended September 30, 2014.

The Company has the following convertible senior notes outstanding: $115.0 million convertible senior notes due 2017 at a conversion price equivalent to approximately $31.56 per share of the Company's common stock (the "2017 Convertible Notes"), $172.5 million convertible senior notes due 2020 at a conversion price equivalent to approximately $45.72 per share of the Company's common stock (the "2020 Convertible Notes"), and $161.0 million convertible senior notes due 2021 at a conversion price equivalent to approximately $59.39 per share of the Company's common stock (the "2021 Convertible Notes").

In the event of conversion, the 2017 Convertible Notes are convertible into cash up to the aggregate principal amount and permit the excess conversion premium to be settled in cash or shares of the Company's common stock. For the 2020 Convertible Notes and 2021 Convertible Notes, the Company has the option to pay cash, issue shares of common stock or any combination thereof for the aggregate amount due upon conversion. The Company's intent is to settle the principal amount of the 2020 and 2021 Convertible Notes in cash upon conversion. As a result, upon conversion of all the convertible senior notes, only the amounts payable in excess of the principal amounts are considered in diluted earnings per share under the treasury stock method. Diluted earnings per share during the periods presented above included the effect of the common shares issuable upon conversion of certain of the convertible senior notes, because the average stock price exceeded the conversion price of these notes. However, as described in Note 10, "Debt—Encore Convertible Notes," and further described below, the Company entered into certain hedge transactions that have the effect of increasing the effective conversion price of the 2017 Convertible Notes to $60.00, the 2020 Convertible Notes to $61.55, and the 2021 Convertible Notes to $83.14. On January 2, 2014, the 2017 Convertible Notes became convertible as certain conditions for conversion were met in the immediately preceding calendar quarter as defined in the applicable indenture. However, none of the 2017 Convertible Notes have been converted.

Note 3: Business Combinations

dlc Acquisition

On June 1, 2015, Cabot acquired dlc, a U.K.-based acquirer and collector of non-performing unsecured consumer debt for approximately £180.6 million (approximately $274.7 million). The dlc Acquisition was financed with borrowings under Cabot's existing revolving credit facility and under Cabot's new senior secured bridge facility. Refer to Note 10, "Debt" for further details of Cabot's revolving credit facility and senior secured bridge facility.

The dlc Acquisition was accounted for using the acquisition method of accounting and, accordingly, the tangible and intangible assets acquired and liabilities assumed were recorded at their estimated fair values as of the date of the acquisition. Fair value measurements have been applied based on assumptions that market participants would use in the pricing of the respective assets and liabilities. As of the date of this Quarterly Report on Form 10-Q, the Company is still finalizing the allocation of the purchase price. The initial purchase price allocation presented below was based on the preliminary assessment of assets acquired and liabilities assumed, which is subject to change based on the final valuation study that is expected to be completed by the fourth quarter of 2015.

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The components of the preliminary purchase price allocation for the dlc Acquisition were as follows (in thousands):

Purchase price:	
Cash paid at acquisition	$268,391
Deferred consideration	6,306
Total purchase price	$274,697
Allocation of purchase price:	
Cash	$30,518
Investment in receivable portfolios	215,988
Deferred court costs	760
Property and equipment	1,327
Other assets	2,384
Liabilities assumed	(44,335)
Identifiable intangible assets	3,670
Goodwill	64,385
Total net assets acquired	$274,697

The goodwill recognized is primarily attributable to synergies that are expected to be achieved by combining dlc and Cabot's existing contingent collections operations. The entire goodwill of $64.4 million related to the dlc Acquisition is not deductible for income tax purposes.

Total acquisition and integration costs related to the dlc Acquisition were approximately $0.1 million and $2.8 million for the three and nine months ended September 30, 2015, respectively, and have been expensed in the accompanying condensed consolidated statements of operations within general and administrative expenses. The amount of revenue and net income attributable to Encore included in the Company’s consolidated statement of operations for the three months ended September 30, 2015 related to dlc was $11.7 million and $2.3 million, respectively. The amount of revenue and net income attributable to Encore included in the Company’s consolidated statement of operations for the nine months ended September 30, 2015 related to dlc was $16.1 million and $3.8 million, respectively.

Other Acquisitions

In addition to the dlc Acquisition discussed above, the Company, through its subsidiaries, completed certain other acquisitions in 2015. These acquisitions were immaterial to the Company’s financial statements individually and in the aggregate.

Refer to Note 3, “Business Combinations” as disclosed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014, for a complete description of the Company’s acquisition activities in 2014.

Note 4: 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.

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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 September 30, 2015			
	Level 1	Level 2	Level 3	Total
Assets				
Foreign currency exchange contracts	$—	$715	$—	$715
Liabilities				
Foreign currency exchange contracts	—	(1,010)	—	(1,010)
Temporary Equity				
Redeemable noncontrolling interests	—	—	(26,934)	(26,934)

	Fair Value Measurements as of December 31, 2014			
	Level 1	Level 2	Level 3	Total
Assets				
Foreign currency exchange contracts	$—	$768	$—	$768
Liabilities				
Foreign currency exchange contracts	—	(1,037)	—	(1,037)
Temporary Equity				
Redeemable noncontrolling interests	—	—	(28,885)	(28,885)

Foreign Currency Exchange Contracts:

The Company uses foreign currency exchange contracts to minimize its exposure to fluctuations in 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 foreign currency exchange rates, and forward and spot prices for currencies.

Redeemable Noncontrolling Interests:

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 interests subject to these arrangements are included in temporary equity as redeemable noncontrolling interests, and are adjusted to their estimated redemption amounts each reporting period with a corresponding adjustment to additional paid-in capital. Future reductions in the carrying amounts are subject to a “floor” amount that is equal to the fair value of the redeemable noncontrolling interests at the time they were originally recorded. The recorded value of the redeemable noncontrolling interests cannot go below the floor level. These adjustments do not affect the calculation of earnings per share.

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The components of the change in the redeemable noncontrolling interests for the periods ended September 30, 2015 and December 31, 2014 are presented in the following table (in thousands):

	Amount	
Balance at December 31, 2013	$26,564	
Initial redeemable noncontrolling interest related to business combinations	4,997	
Net loss attributable to redeemable noncontrolling interests	(4,513	)
Adjustment of the redeemable noncontrolling interests to fair value	5,730	
Effect of foreign currency translation attributable to redeemable noncontrolling interests	(3,893	)
Balance at December 31, 2014	28,885	
Net loss attributable to redeemable noncontrolling interests	(316	)
Adjustment of the redeemable noncontrolling interests to fair value	1,323	
Effect of foreign currency translation attributable to redeemable noncontrolling interests	(2,958	)
Balance at September 30, 2015	$26,934	

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 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 estimated blended market participant cost to collect and discount rate is approximately 50.3% and 12.0%, respectively, for United States portfolios, and approximately 30.0% and 13.4%, respectively, for Europe portfolios. Using this method, the fair value of investment in receivable portfolios approximates the carrying value as of September 30, 2015 and December 31, 2014. 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 United States and Europe portfolios by approximately $41.2 million and $57.5 million, respectively, as of September 30, 2015. 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. The carrying value of the investment in receivable portfolios was $2.3 billion and $2.1 billion as of September 30, 2015 and December 31, 2014, respectively.

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.

Receivables Secured By Property Tax Liens:

The fair value of receivables secured by property tax liens is estimated by discounting the future cash flows of the portfolio using a discount rate equivalent to the current rate at which similar portfolios would be originated. For tax liens purchased directly from taxing authorities, the fair value is estimated by discounting the expected future cash flows of the portfolio using a discount rate equivalent to the interest rate expected when acquiring these tax liens. The carrying value of receivables secured by property tax liens approximates fair value. Additionally, the carrying value of the related interest receivable also approximates fair value.

Debt:

Encore’s senior secured notes and borrowings under its revolving credit and term loan facilities are carried at historical amounts, adjusted for additional borrowings less principal repayments, which approximate fair value.

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Encore's convertible senior notes are carried at historical cost, adjusted for the debt discount. The carrying value of the convertible senior notes was $448.5 million less debt discount of $44.3 million as of September 30, 2015, and $448.5 million less debt discount of $51.2 million as of December 31, 2014, respectively. The fair value estimate for these convertible senior notes, which incorporates quoted market prices, was approximately $451.9 million and $507.4 million as of September 30, 2015 and December 31, 2014, respectively.

Propel's borrowings under its revolving credit facilities, term loan facility, and securitized notes are carried at historical amounts, adjusted for additional borrowings less principal repayments, which approximate fair value.

The carrying value of the Cabot and Marlin senior secured notes was $1.1 billion, including debt premium of $57.4 million and $1.1 billion, including debt premium of $67.3 million, as of September 30, 2015 and December 31, 2014, respectively. The fair value estimate for these senior notes, which incorporates quoted market prices, approximated the carrying value as of September 30, 2015 and December 31, 2014, respectively.

Cabot's borrowings under its senior revolving credit facility and senior secured bridge loan facility, entered into in June 2015 in connection with the dlc Acquisition, are carried at historical amounts, adjusted for additional borrowings less principal repayments, which approximates fair value.

The Company's preferred equity certificates are legal obligations to the noncontrolling shareholders of two of its subsidiaries, Janus Holdings and Cabot Holdings. They are carried at the face amount, plus any accrued interest. The Company determined, at the time of the acquisition of a controlling interest in Cabot (the "Cabot Acquisition") and at September 30, 2015, that the carrying value of these preferred equity certificates approximates fair value.

Note 5: 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.

Foreign Currency Exchange Contracts

The Company has operations in foreign countries, which exposes the Company to foreign currency exchange rate fluctuations due to transactions denominated in foreign currencies. To mitigate this risk, the Company enters into derivative financial instruments, principally Indian rupee forward contracts, which are designated as cash flow hedges, to mitigate fluctuations in the cash payments of future forecasted transactions. 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.

Gains and losses on cash flow hedges are recorded in other comprehensive income ("OCI") until the hedged transaction is recorded in the consolidated financial statements. Once the underlying transaction is recorded in the consolidated financial statements, the Company reclassifies OCI on the derivative into earnings. If all or a portion of the forecasted transaction is cancelled, this would render all or a portion of the cash flow hedge ineffective and the Company would reclassify the ineffective portion of the hedge into earnings. The Company generally does not experience ineffectiveness of the hedge relationship and the accompanying consolidated financial statements do not include any such gains or losses.

As of September 30, 2015, the total notional amount of the forward contracts to buy Indian rupees in exchange for U.S. dollars was $43.8 million. All of these outstanding contracts qualified for hedge accounting treatment. The Company estimates that approximately $0.5 million of net derivative gain 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 nine months ended September 30, 2015 and 2014.

The Company does not enter into derivative instruments for trading or speculative purposes.

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

	September 30, 2015		December 31, 2014	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:				
Foreign currency exchange contracts	Other liabilities	$(1,010)	Other liabilities	$(1,037)
Foreign currency exchange contracts	Other assets	715	Other assets	768

The following table summarizes the effects of derivatives in cash flow hedging relationships on the Company's condensed consolidated statements of operations for the three and nine months ended September 30, 2015 and 2014 (in thousands):

	Gain or (Loss) Recognized in OCI- Effective Portion		Location of Gain or (Loss) Reclassified from OCI into Income - Effective Portion	Gain or (Loss) Reclassified from OCI into Income - Effective Portion		Location of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing	Amount of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing	
	Three Months Ended September 30,			Three Months Ended September 30,			Three Months Ended September 30,	
	2015	2014		2015	2014		2015	2014
Foreign currency exchange contracts	$(670)	$(429)	Salaries and employee benefits	$(153)	$(243)	Other (expense) income	$—	$—
Foreign currency exchange contracts	(126)	(79)	General and administrative expenses	(28)	(46)	Other (expense) income	—	—

	Gain or (Loss) Recognized in OCI- Effective Portion		Location of Gain or (Loss) Reclassified from OCI into Income - Effective Portion	Gain or (Loss) Reclassified from OCI into Income - Effective Portion		Location of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing	Amount of Gain or (Loss) Recognized - Ineffective Portion and Amount Excluded from Effectiveness Testing	
	Nine Months Ended September 30,			Nine Months Ended September 30,			Nine Months Ended September 30,	
	2015	2014		2015	2014		2015	2014
Foreign currency exchange contracts	$(593)	$2,215	Salaries and employee benefits	$(468)	$(818)	Other (expense) income	$—	$—
Foreign currency exchange	24	242	General and administrative	(75)	(143)	Other (expense) income	—	—

contracts expenses

Note 6: Investment in Receivable Portfolios, Net

In accordance with the authoritative guidance for loans and debt securities acquired with deteriorated credit quality, discrete receivable portfolio purchases during 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 and telecom, purchased consumer bankruptcy, and mortgage portfolios. We further group these static pools by geographic region or location. 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

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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.

The Company utilizes its proprietary forecasting models to continuously evaluate the economic life of each pool. During the quarter ended September 30, 2014, the Company revised the forecasting methodology it uses to value and calculate IRRs on its portfolios in the United States by extending the collection forecasts from 84 or 96 months to 120 months. This change was made as a result of the Company experiencing collections beyond 84 or 96 months and an increased confidence in its ability to forecast future cash collections to 120 months. Extending the collection forecast did not result in a material increase to any quarterly pool group's IRR or revenue for the quarter. The Company has historically included collections to 120 months in its estimated remaining collection disclosures and when evaluating the economic returns of its portfolio purchases.

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 purchase price of a Cost Recovery Portfolio has been fully recovered.

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

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

	Accretable Yield	Estimate of Zero Basis Cash Flows	Total [7]
December 31, 2014	$2,993,321	$66,392	$3,059,713
Revenue recognized, net[1]	(248,539)	(15,571)	(264,110)
Net additions on existing portfolios[2]	120,729	39,607	160,336
Additions for current purchases, net[2]	85,692	—	85,692
Balance at March 31, 2015	2,951,203	90,428	3,041,631
Revenue recognized, net[1]	(243,425)	(26,876)	(270,301)
Net additions on existing portfolios[2]	91,294	74,586	165,880
Additions for current purchases, net[2], [3]	395,032	—	395,032
Balance at June 30, 2015	3,194,104	138,138	3,332,242