

ENCORE CAPITAL GROUP INC
Form 10-Q
August 08, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

OR

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

For the transition period from _____ to _____.

COMMISSION FILE NUMBER: 000-26489

ENCORE CAPITAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

8875 Aero Drive, Suite 200

48-1090909
(IRS Employer

Identification No.)

92123

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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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

| Class | Outstanding at July 30, 2007 |
|--------------------------------|------------------------------|
| Common Stock, \$0.01 par value | 22,829,477 shares |

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ENCORE CAPITAL GROUP, INC.

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

(In Thousands, Except Par Value Amounts)

| | June 30, 2007 (Unaudited) | December 31, 2006(A) |
|---|---------------------------------|-------------------------|
| Assets | | |
| Cash and cash equivalents | \$ 4,495 | \$ 10,791 |
| Restricted cash | 3,942 | 4,660 |
| Accounts receivable, net | 3,768 | 2,599 |
| Investment in receivable portfolios, net | 327,586 | 300,348 |
| Property and equipment, net | 4,954 | 5,249 |
| Prepaid income tax | 8,079 | 3,727 |
| Purchased servicing asset | 528 | 1,132 |
| Forward flow asset | 21,078 | 27,566 |
| Other assets | 25,618 | 21,903 |
| Goodwill | 13,735 | 13,735 |
| Identifiable intangible assets, net | 3,092 | 3,628 |
| Total assets | \$ 416,875 | \$ 395,338 |
| Liabilities and stockholders equity | | |
| Liabilities: | | |
| Accounts payable and accrued liabilities | \$ 18,752 | \$ 23,744 |
| Accrued profit sharing arrangement | | 6,869 |
| Deferred tax liabilities, net | 12,491 | 10,667 |
| Deferred revenue | 2,636 | 2,156 |
| Purchased servicing obligation | 312 | 634 |
| Debt | 223,009 | 200,132 |
| Total liabilities | 257,200 | 244,202 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Convertible preferred stock, \$.01 par value, 5,000 shares authorized, no shares issued and outstanding | | |
| Common stock, \$.01 par value, 50,000 shares authorized, 22,829 shares and 22,781 shares issued and outstanding as of June 30, 2007 and December 31, 2006, respectively | 228 | 228 |
| Additional paid-in capital | 69,678 | 66,532 |
| Accumulated earnings | 88,769 | 83,933 |
| Accumulated other comprehensive income | 1,000 | 443 |
| Total stockholders equity | 159,675 | 151,136 |
| Total liabilities and stockholders equity | \$ 416,875 | \$ 395,338 |

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(A) Derived from the audited consolidated financial statements as of December 31, 2006.

See accompanying notes to unaudited condensed consolidated financial statements.

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

(In Thousands, Except Per Share Amounts)

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | June 30, 2007 | June 30, 2006 | June 30, 2007 | June 30, 2006 |
| Revenues | | | | |
| Revenue from receivable portfolios, net | \$ 64,021 | \$ 59,604 | \$ 126,174 | \$ 117,178 |
| Servicing fees and other related revenue | 3,207 | 6,329 | 6,429 | 9,235 |
| Total revenues | 67,228 | 65,933 | 132,603 | 126,413 |
| Operating expenses | | | | |
| Salaries and employee benefits | 16,064 | 16,306 | 33,250 | 32,585 |
| Stock-based compensation expense | 1,204 | 1,464 | 2,005 | 2,845 |
| Cost of legal collections | 21,159 | 12,944 | 38,780 | 24,222 |
| Other operating expenses | 6,239 | 5,655 | 11,983 | 12,101 |
| Collection agency commissions | 2,867 | 5,032 | 6,161 | 9,645 |
| General and administrative expenses | 4,232 | 3,300 | 8,503 | 7,033 |
| Depreciation and amortization | 840 | 968 | 1,709 | 1,928 |
| Total operating expenses | 52,605 | 45,669 | 102,391 | 90,359 |
| Income before other income (expense) and income taxes | 14,623 | 20,264 | 30,212 | 36,054 |
| Other income (expense) | | | | |
| Interest expense | (3,336) | (3,102) | (6,256) | (6,367) |
| Contingent interest expense | (888) | (4,235) | (4,123) | (8,921) |
| Pay-off of future contingent interest | (11,733) | | (11,733) | |
| Other (expense) income | (42) | 284 | 74 | 334 |
| Total other expense | (15,999) | (7,053) | (22,038) | (14,954) |
| Income before income taxes | (1,376) | 13,211 | 8,174 | 21,100 |
| Benefit (provision) for income taxes | 555 | (5,716) | (3,338) | (8,927) |
| Net (loss) income | \$ (821) | \$ 7,495 | \$ 4,836 | \$ 12,173 |
| Basic (loss) earnings per share computation: | | | | |
| Net (loss) income available to common stockholders | \$ (821) | \$ 7,495 | \$ 4,836 | \$ 12,173 |
| Weighted average shares outstanding | 22,801 | 22,776 | 22,792 | 22,729 |
| (Loss) earnings per share Basic | \$ (0.04) | \$ 0.33 | \$ 0.21 | \$ 0.54 |

Diluted (loss) earnings per share computation:

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| | | | | | | | | |
|---|----|--------|----|--------|----|--------|----|--------|
| Net (loss) income available to common stockholders | \$ | (821) | \$ | 7,495 | \$ | 4,836 | \$ | 12,173 |
| Weighted average shares outstanding | | 22,803 | | 22,776 | | 22,794 | | 22,729 |
| Incremental shares from assumed conversion of stock options | | | | 615 | | 594 | | 663 |
| Diluted weighted average shares outstanding | | 22,803 | | 23,391 | | 23,388 | | 23,392 |
| (Loss) earnings per share Diluted | \$ | (0.04) | \$ | 0.32 | \$ | 0.21 | \$ | 0.52 |

See accompanying notes to unaudited condensed consolidated financial statements.

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ENCORE CAPITAL GROUP, INC.

Condensed Consolidated Statement of Stockholders Equity

(Unaudited, In Thousands)

| | Common Stock | | Additional Paid-In Capital | Accumulated Earnings | Accumulated Other Comprehensive Income | Total Equity | Comprehensive Income |
|---|--------------|--------|----------------------------------|-------------------------|---|-----------------|-------------------------|
| | Shares | Par | | | | | |
| Balance at December 31, 2006 | 22,781 | \$ 228 | \$ 66,532 | \$ 83,933 | \$ 443 | \$ 151,136 | |
| Net income | | | | 4,836 | | 4,836 | 4,836 |
| Other comprehensive income: | | | | | | | |
| unrealized gain on non-qualified deferred compensation plan assets | | | | | 133 | 133 | 133 |
| unrealized gain on cash flow hedge | | | | | 424 | 424 | 424 |
| Exercise of stock options | 42 | | 263 | | | 263 | |
| Vesting of share based awards | 6 | | | | | | |
| Stock-based compensation related to stock options | | | 2,005 | | | 2,005 | |
| Tax provision related to stock option exercises | | | (107) | | | (107) | |
| Tax benefit from convertible note interest expense | | | 985 | | | 985 | |
| Balance at June 30, 2007 | 22,829 | \$ 228 | \$ 69,678 | \$ 88,769 | \$ 1,000 | \$ 159,675 | \$ 5,393 |

See accompanying notes to unaudited condensed consolidated financial statements.

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

(Unaudited, In Thousands)

| | Six Months Ended | |
|--|------------------|-----------------|
| | June 30, 2007 | 2006 |
| Operating activities | | |
| Gross collections | \$ 184,152 | \$ 166,802 |
| Less: | | |
| Amounts collected on behalf of third parties | (266) | (351) |
| Amounts applied to principal on receivable portfolios | (58,974) | (49,411) |
| Servicing fees | 64 | 99 |
| Operating expenses | (100,744) | (81,201) |
| Interest payments | (6,010) | (6,095) |
| Contingent interest payments | (22,724) | (12,601) |
| Other income | 74 | 334 |
| Decrease in restricted cash | 718 | 185 |
| Income taxes | (5,362) | (863) |
| Excess tax benefits from stock-based payment arrangements | (123) | (749) |
| Net cash (used in) provided by operating activities | (9,195) | 16,149 |
| Investing activities | | |
| Purchases of receivable portfolios, net of forward flow allocation | (80,035) | (43,842) |
| Collections applied to principal of receivable portfolios | 58,974 | 49,411 |
| Proceeds from put-backs of receivable portfolios | 1,574 | 1,984 |
| Purchases of property and equipment | (878) | (790) |
| Net cash (used in) provided by investing activities | (20,365) | 6,763 |
| Financing activities | | |
| Proceeds from notes payable and other borrowings | 27,000 | 4,500 |
| Repayment of notes payable and other borrowings | (4,000) | (25,134) |
| Proceeds from exercise of common stock options | 263 | 144 |
| Excess tax benefits from stock-based payment arrangements | 123 | 749 |
| Repayment of capital lease obligations | (122) | (119) |
| Net cash provided by (used in) financing activities | 23,264 | (19,860) |
| Net (decrease) increase in cash | (6,296) | 3,052 |
| Cash and cash equivalents, beginning of period | 10,791 | 7,026 |
| Cash and cash equivalents, end of period | \$ 4,495 | \$ 10,078 |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**ENCORE CAPITAL GROUP, INC.****Condensed Consolidated Statements of Cash Flows (cont.)****Reconciliation of Net Income to Net Cash Provided by Operating Activities**

(Unaudited, In Thousands)

| | Six Months Ended | |
|---|-------------------|------------------|
| | 2007 | June 30, 2006 |
| Net income | \$ 4,836 | \$ 12,173 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,709 | 1,928 |
| Amortization of loan costs | 607 | 737 |
| Stock-based compensation expense | 2,005 | 2,845 |
| Tax benefit from convertible note interest expense | 985 | 882 |
| Tax (provision) benefit from stock option exercises | (107) | 793 |
| Deferred income tax expense | 1,824 | 2,222 |
| Excess tax benefits from stock-based payment arrangements | (123) | (749) |
| Reversal of impairment on receivable portfolios, net | (1,263) | (146) |
| Changes in operating assets and liabilities | | |
| Decrease in restricted cash | 718 | 185 |
| (Increase) decrease in other assets | (4,463) | 534 |
| (Increase) decrease in prepaid income tax | (4,352) | 4,239 |
| Decrease in accrued profit sharing arrangement | (6,869) | (3,680) |
| Increase in deferred revenue and purchased service obligation | 158 | |
| (Decrease) in accounts payable and accrued liabilities | (4,860) | (5,814) |
| Net cash (used in) provided by operating activities | \$ (9,195) | \$ 16,149 |

See accompanying notes to unaudited condensed consolidated financial statements.

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ENCORE CAPITAL GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

Encore Capital Group, Inc. (Encore), through its subsidiaries (the Company), is a systems-driven purchaser and manager of charged-off consumer receivable portfolios and, through its wholly owned subsidiary Ascension Capital Group, Inc. (Ascension), a provider of bankruptcy services to the finance industry. The Company acquires its receivable portfolios at deep discounts from their face values using its proprietary valuation process that is based on the consumer attributes of the underlying accounts. Based upon the Company's ongoing analysis of these accounts, it employs a dynamic mix of collection strategies to maximize its return on investment. The receivable portfolios the Company purchases consist primarily of unsecured, charged-off domestic consumer credit card, auto deficiency, telecom, and healthcare receivables purchased from national financial institutions, major retail credit corporations, telecom companies, hospitals, and resellers of such portfolios. Acquisitions of receivable portfolios are financed by operations and by borrowings from third parties. See Note 6 for further discussion of the Company's debt.

Note 2: Summary of Significant Accounting Policies

Financial Statement Preparation

The accompanying interim condensed consolidated financial statements have been prepared by Encore, without audit, in accordance with the instructions on Form 10-Q and Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission and, therefore, do not necessarily include all information and footnotes necessary for a fair presentation of its consolidated financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States.

In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the Company's consolidated results of operations, financial position and cash flows. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006. Operating results for interim periods are not necessarily indicative of operating results for an entire fiscal year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts and the disclosure of contingent amounts in the Company's financial statements and the accompanying notes. Actual results could materially differ from those estimates.

Principles of Consolidation

The Company's condensed consolidated financial statements include the assets, liabilities and operating results of its majority-owned subsidiaries. The ownership and operating results relating to the minority holders of consolidated subsidiaries is reflected as minority interest and is not significant. All significant intercompany accounts and transactions have been eliminated. The Company does not have any investments in entities it believes are variable interest entities for which the Company is the primary beneficiary.

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Effects of New Accounting Pronouncement

On July 13, 2006, the Financial Accounting Standards Board issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN No. 48), which is effective for fiscal years beginning after December 15, 2006. FIN No. 48 establishes recognition and measurement thresholds that must be met before a tax benefit can be recognized in the financial statements. The Company has analyzed the effects of the new standard and its potential impact on its financial statements. The Company has determined that the effects of FIN No. 48 do not have a material impact on its consolidated financial statements.

New Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board issued Statement No. 159, *Fair Value Option for Financial Assets and Liabilities including an amendment of FASB Statement No. 115* (SFAS No. 159), which is effective for financial statements issued for fiscal years beginning after November 15, 2007. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Company is currently analyzing the effects of the new standard and its potential impact on its financial statements, if any.

In September 2006, the Financial Accounting Standards Board issued Statement No. 157, *Fair Value Measurements* (SFAS No. 157), which is effective for financial statements issued for fiscal years beginning after November 15, 2007. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The Company is currently analyzing the effects of the new standard and its potential impact on its financial statements, if any.

Note 3: Stock-Based Compensation

On January 1, 2006, the Company implemented Statement of Financial Accounting Standard No. 123R, *Share-Based Payment* (SFAS No. 123R), which is a revision of Statement of Financial Accounting Standard No. 123, *Accounting For Stock-Based Compensation* (SFAS No. 123). SFAS No. 123R requires the Company to establish assumptions and estimates of the weighted-average fair value of stock options granted and restricted stock issued (Performance Shares), as well as using a valuation model to calculate the fair value of stock-based awards. The Company uses the Black-Scholes option-pricing model to determine the fair-value of stock-based awards. All options are amortized over the requisite service periods of the awards, which are generally the vesting periods.

The expected life of options granted, expected volatility, and forfeitures are based on data specific to each employee class under the assumptions that different classes of employees can act differently because of title, rank, number of options granted, and other like characteristics. For the purposes of this analysis, these classes include: (i) officers (as defined under Section 16 of the Securities Exchange Act of 1934) and (ii) all others receiving options. The assumptions below are used by the Company to determine the fair value of stock-based awards.

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Expected Life. The expected life of options granted represents the period of time for which the options are expected to be outstanding. The Company retained an independent third party to perform valuation procedures in order to determine the expected life of the options, which took into account the percentage of option exercises, the percentage of options that expire unexercised, and the percentage of options outstanding. The Company used this valuation to determine the expected life of the options, which are 5.2 years for officers and 4.7 years for all others.

Expected Volatility. The expected volatility is based on the historical volatility of the Company's common stock over the estimated expected life of the options, which is 5.2 years for officers and 4.7 years for all others.

Risk-Free Interest Rate. The risk-free interest rate is derived from the U.S. Treasury yield curve in effect at the date of grant.

Dividends. The Company does not currently anticipate paying any cash dividends on its common stock. Consequently, the Company uses an expected dividend yield of zero in the Black-Scholes option valuation model.

Forfeitures. SFAS No. 123R requires the Company to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. To determine an expected forfeiture rate, the Company examined the historical employee turnover rate over the prior five years as a proxy for forfeitures. Based on the internal analysis, the expected forfeiture rates were determined to be 10.6% of options granted to officers and 11.5% of options granted to all others.

The fair value of options granted is estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions (there were no options granted to officers for the six months ended June 30, 2007):

| | Six months Ended June 30, 2007 | Six months Ended June 30, 2006 |
|---|---|---|
| Weighted average fair value of options granted | \$ 7.52 | \$ 5.34 |
| Risk free interest rate | 4.80% | 4.95% |
| Dividend yield | 0.0% | 0.0% |
| Volatility factor of the expected market price of the Company's common stock | 78.94% | 45.84% |
| Weighted-average expected life of options | 4.7 Years | 3 Years |

Compensation expense is recognized only for those options expected to vest, with forfeitures estimated at the date of grant based on the Company's historical experience and future expectations. For the six months ended June 30, 2007, \$2.0 million was recognized as stock-based compensation expense under SFAS No. 123R. Unrecognized compensation cost related to stock options and performance shares as of June 30, 2007 was \$8.8 million and the weighted-average remaining expense period of these outstanding stock

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options and performance shares is approximately 2.9 years. The fair value of options vested for the six months ended June 30, 2007 and 2006 was \$2.4 million and \$2.9 million, respectively.

On March 30, 2005, the Board of Directors of the Company adopted a new 2005 Stock Incentive Plan (2005 Plan) for Board members, employees, officers, and executives of, and consultants and advisors to, the Company. The 2005 Plan was effective as of March 30, 2005, and was approved by the Company's stockholders at the annual meeting on May 3, 2005. The 2005 Plan provides for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, performance shares, and performance-based awards to eligible individuals. Upon adoption, an aggregate of 1,500,000 shares of the Company's common stock were available for awards under the 2005 Plan, plus ungranted shares of stock that were available for future awards under the 1999 Equity Participation Plan (1999 Plan). In addition, shares subject to options granted under either the 1999 Plan or the 2005 Plan that terminate or expire without being exercised are available for grant under the 2005 Plan.

On May 1, 2007, the Company issued 268,000 performance shares under the 2005 Plan. As defined in the applicable agreements, these performance shares will fully vest in three or five years. The performance share grants issued were valued at \$11.90 per share, which is the fair market value at the date of grant, and in accordance with SFAS No. 123R are being amortized on a straight line basis over the vesting periods.

Performance Share activity and related information is as follows for the six months ended June 30, 2007:

| Performance Shares | Non-Vested Shares | Weighted-Average Grant Date | |
|---------------------------------------|----------------------|--------------------------------|-------|
| | | Fair Value | |
| Beginning of period December 31, 2006 | 47,700 | \$ | 16.19 |
| Awarded | 268,000 | \$ | 11.90 |
| Released | | | |
| Cancelled/forfeited | (13,300) | \$ | 15.38 |
| End of period as of June 30, 2007 | 302,400 | \$ | 12.42 |

A summary of the Company's stock option activity and related information is as follows for the six months ended June 30, 2007:

| | Number of Shares | Option Price Per Share | Weighted-Average Exercise Price | Aggregate Intrinsic Value | |
|----------------------------------|------------------------|------------------------------|------------------------------------|---------------------------------|--------|
| | | | | <i>(in thousands)</i> | |
| Outstanding at December 31, 2006 | 2,535,018 | \$ 0.35 - \$20.30 | \$ 10.25 | | |
| Granted | 95,500 | 11.30 | 11.30 | | |
| Cancelled/forfeited | (208,200) | 16.17 - 20.30 | 17.56 | | |
| Exercised | (42,166) | 0.35 - 12.01 | 6.25 | | |
| Outstanding at June 30, 2007 | 2,380,152 | \$ 0.35 - \$20.09 | \$ 9.73 | \$ | 11,154 |
| Exercisable at June 30, 2007 | 1,646,748 | \$ 0.35 - \$20.09 | \$ 7.83 | \$ | 10,106 |

The total intrinsic value of options exercised during the six months ended June 30, 2007 and 2006 was \$0.2 million and \$1.4 million, respectively. As of June 30, 2007, the weighted-average remaining life of options outstanding and options exercisable was 6.65 years and 6.06 years, respectively.

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The following table summarizes outstanding and exercisable options as of June 30, 2007:

| Exercise Prices | Options Outstanding | | | Options Exercisable | |
|------------------|---------------------|---------------------------------|---------------------------------|---------------------|---------------------------------|
| | Number Outstanding | Weighted-Average Exercise Price | Weighted-Average Remaining Life | Number Outstanding | Weighted-Average Exercise Price |
| \$0.35 - \$0.52 | 608,165 | \$ 0.51 | 5.18 | 538,721 | \$ 0.51 |
| 1.00 | 199,004 | 1.00 | 3.71 | 199,004 | 1.00 |
| 1.30 | 65,832 | 1.30 | 5.58 | 65,832 | 1.30 |
| 2.95 | 37,500 | 2.95 | 5.81 | 37,500 | 2.95 |
| 4.50 | 833 | 4.50 | 5.85 | 833 | 4.50 |
| 10.60 | 42,000 | 10.60 | 8.93 | 8,400 | 10.60 |
| 11.00 | 150,001 | 11.00 | 6.33 | 150,001 | 11.00 |
| 11.30 | 95,500 | 11.30 | 9.57 | | |
| 11.94 | 75,000 | 11.94 | 9.15 | | |
| 12.01 | 69,666 | 12.01 | 6.33 | 69,666 | 12.01 |
| 14.59 | 10,500 | 14.59 | 8.83 | 2,100 | 14.59 |
| 15.42 | 300,000 | 15.42 | 7.84 | 200,000 | 15.42 |
| 16.17 | 95,000 | 16.17 | 6.77 | 95,000 | 16.17 |
| 16.19 | 226,151 | 16.19 | 8.34 | 89,690 | 16.19 |
| 16.93 | 10,000 | 16.93 | 6.85 | 10,000 | 16.93 |
| 17.83 | 35,000 | 17.83 | 7.95 | 23,334 | 17.83 |
| 18.02 | 50,000 | 18.02 | 8.09 | 16,667 | 18.02 |
| 18.63 | 250,000 | 18.63 | 7.22 | 100,000 | 18.63 |
| 20.09 | 60,000 | 20.09 | 7.59 | 40,000 | 20.09 |
| \$0.35 - \$20.09 | 2,380,152 | \$ 9.73 | 6.65 | 1,646,748 | \$ 7.83 |

The Financial Accounting Standards Board issued Statement No. 128, *Earnings per Share* (SFAS No. 128), which requires companies to disclose the number of stock options that have the potential to dilute basic earnings per share in the future, but which were not included in the computation of diluted earnings per share, because to do so would have been anti-dilutive in the periods presented. Employee stock options to purchase approximately 1,181,000 and 1,277,000 shares of common stock during the three months and six months ended June 30, 2007, respectively, and employee stock options to purchase approximately 1,302,000 and 1,291,000 shares of common stock during the three months and six months ended June 30, 2006, respectively, were outstanding but not included in the computation of diluted earnings per common share because the effect on diluted earnings per share would be anti-dilutive.

Note 4: Investment in Receivable Portfolios, Net

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

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In compliance with SOP 03-03, the Company accounts for its investments in consumer receivable portfolios using either the interest method or the cost recovery method. The interest method applies an effective interest rate, or internal rate of return (IRR), to the cost basis of the pool, which is to remain unchanged throughout the life of the pool unless there is an increase in subsequent expected cash flows. Subsequent increases in cash flows expected to be collected are generally recognized prospectively through an upward adjustment of the pool's effective interest rate over its remaining life. Subsequent decreases in expected cash flows do not change the effective interest rate, but are recognized as an impairment of 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 statement of financial condition.

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

If the amount and timing of future cash collections on a pool of receivables are not reasonably estimable, the Company accounts for such portfolios on the cost recovery method (Cost Recovery Portfolios). The accounts in these portfolios have different risk characteristics than those included in other portfolios acquired during the same quarter, or the necessary information was not available to estimate future cash flows and, accordingly, they were not aggregated with other portfolios. Under the cost recovery method of accounting, no income is recognized until the purchase price of a Cost Recovery Portfolio has been fully recovered. At June 30, 2007, there were no portfolios accounted for using the cost recovery method.

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 cash flows at the beginning and end of the current period (*in thousands*):

| | Six Months Ended June 30, 2007 | | |
|---|---------------------------------------|-----------------------------|-------------------|
| | Estimate of | | |
| | Zero Basis Cash Flows | Accretable Yield | Total |
| Beginning balance at December 31, 2006 | \$ 38,967 | \$ 417,981 | \$ 456,948 |
| Revenue recognized, net | (5,108) | (57,045) | (62,153) |
| (Reductions) additions on existing portfolios | (3,956) | 20,438 | 16,482 |
| Additions for current purchases | | 52,980 | 52,980 |
| Balance at March 31, 2007 | \$ 29,903 | \$ 434,354 | \$ 464,257 |
| Revenue recognized, net | (4,047) | (59,974) | (64,021) |
| Additions on existing portfolios | 4,442 | 39,959 | 44,401 |
| Additions for current purchases | | 58,837 | 58,837 |
| Balance at June 30, 2007 | \$ 30,298 | \$ 473,176 | \$503,474 |

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| | Six Months Ended June 30, 2006 | | |
|---|---------------------------------------|-----------------------------|-------------------|
| | Estimate of | | |
| | Zero Basis Cash Flows | Accretable Yield | Total |
| Beginning balance at December 31, 2005 | \$ 57,116 | \$ 360,961 | \$ 418,077 |
| Revenue recognized, net | (6,507) | (51,067) | (57,574) |
| (Reductions) additions on existing portfolios | (6,615) | 7,175 | 560 |
| Additions for current purchases | | 28,708 | 28,708 |
| Balance at March 31, 2006 | \$ 43,994 | \$ 345,777 | \$ 389,771 |
| Revenue recognized, net | (6,734) | (52,870) | (59,604) |
| Additions on existing portfolios | 19,961 | 7,326 | 27,287 |
| Additions for 12 month curve extension | | 86,020 | 86,020 |
| Additions for current purchases | | 22,950 | 22,950 |
| Balance at June 30, 2006 | \$ 57,221 | \$ 409,203 | \$ 466,424 |

During the three months ended June 30, 2007, the Company purchased receivable portfolios with a face value of \$1.3 billion for \$41.1 million, or a purchase cost of 3.1% of face value. The estimated future collections at acquisition for these portfolios amounted to \$97.6 million. During the six months ended June 30, 2007, the Company purchased receivable portfolios with a face value of \$3.9 billion for \$86.5 million, or a purchase cost of 2.2% of face value. The estimated collections at acquisition for these portfolios amounted to \$196.0 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, 2007 and 2006, approximately \$4.0 million and \$6.7 million, respectively, was recognized as revenue on portfolios for which the related cost basis has been fully recovered. During the six months ended June 30, 2007 and 2006, approximately \$9.2 million and \$13.2 million, respectively, was recognized as revenue on portfolios for which the related cost basis has been fully recovered.

During the quarter ended June 30, 2007, the Company revised the model it uses to value portfolio for the first six months of ownership. Effective April 1, 2007, this model was updated to extend future projected collections from 54/60 months to 72 months. This change was made as a result of the Company's increased confidence in its ability to forecast future cash collections to 72 months. This change did not result in a significant change in forecasted collections or revenue as of, or for the quarter ended, June 30, 2007.

During the quarter ended June 30, 2006, the Company revised its forecasting methodology by extending the collection forecast from 60 months to 72 months. Extending the collection forecast in its model from 60 months to 72 months resulted in an increase in the aggregate total estimated remaining collections for the receivable portfolios by \$86.0 million, or 13.6% as of June 30, 2006.

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The following table summarizes the changes in the net balance of the investment in receivable portfolios during the six months ended June 30, 2007 (in thousands, except percentages):

| | For the Six Months Ended June 30, 2007 | | | Total |
|--|--|--------------------------|-----------------------|-------------------|
| | Accrual Basis Portfolios | Cost Recovery Portfolios | Zero Basis Portfolios | |
| Balance, beginning of period | \$ 300,348 | \$ | \$ | \$ 300,348 |
| Purchases of receivable portfolios | 86,523 | | | 86,523 |
| Gross collections ¹ | (174,730) | | (8,664) | (183,394) |
| Basis adjustments | (1,574) | | | (1,574) |
| Revenue recognized ¹ | 115,756 | | 8,664 | 124,420 |
| Impairment reversals, net | 1,263 | | | 1,263 |
| Balance, end of period | \$ 327,586 | \$ | \$ | \$ 327,586 |
| Revenue as a percentage of collections | 67.0% | 0.0% | 100.0% | 68.5% |

¹ Gross collections and revenue related to the retained interest are not included in these tables. Zero basis collections and revenue related to the retained interest (which was fully amortized in the second quarter of 2004) were \$0.5 million and \$0.7 million for the six months ended June 30, 2007 and 2006, respectively. The following table summarizes the change in the valuation allowance for investment in receivable portfolios during the six months ended June 30, 2007 (in thousands):

| | Valuation Allowance |
|---------------------------------|---------------------|
| Balance at December 31, 2006 | \$ 4,522 |
| Provision for impairment losses | 1,008 |
| Reversal of prior allowance | (1,225) |
| Balance at March 31, 2007 | \$ 4,305 |
| Provision for impairment losses | 1,408 |
| Reversal of prior allowance | (2,454) |
| Balance at June 30, 2007 | \$ 3,259 |

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|------------------|---------------------------|-------------------|
| | 2007 | 2006 | 2007 | 2006 |
| Collection sites | \$ 32,516 | \$ 33,579 | \$ 66,511 | \$ 74,861 |
| Legal collections | 44,430 | 29,065 | 84,160 | 54,836 |
| Sales | 7,972 | 1,985 | 15,269 | 9,094 |
| Collection agencies | 7,686 | 13,951 | 16,503 | 26,915 |
| Other | 1,007 | 606 | 1,709 | 1,096 |
| Gross collections for the period | \$ 93,611 | \$ 79,186 | \$ 184,152 | \$ 166,802 |

Note 5: Other Assets

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

| | June 30, 2007 | December 31, 2006 |
|------------------------------|--------------------------|------------------------------|
| Debt issuance costs | \$ 3,704 | \$ 4,272 |
| Deferred court costs, net | 15,652 | 10,934 |
| Deferred compensation assets | 3,245 | 4,256 |
| Prepaid employment agreement | 778 | 1,111 |
| Other | 2,239 | 1,330 |
| | \$ 25,618 | \$ 21,903 |

Table of Contents**Note 6: Debt**

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

| | June 30, 2007 | December 31, 2006 |
|---------------------------|------------------|----------------------|
| Convertible Senior Notes | \$ 100,000 | \$ 100,000 |
| Revolving Credit Facility | 122,669 | 99,669 |
| Capital Lease Obligations | 340 | 463 |
| | \$ 223,009 | \$ 200,132 |

Convertible Senior Notes

In 2005, the Company issued \$100.0 million of 3.375% convertible senior notes due September 19, 2010 (the *Convertible Notes*). Interest on the *Convertible Notes* is payable semi-annually, in arrears on March 19 and September 19 of each year. The *Convertible Notes* rank equally with the Company's existing and future senior indebtedness and are senior to the Company's potential future subordinated indebtedness. Prior to the implementation of the net-share settlement feature discussed below, the *Convertible Notes* were convertible, prior to maturity, subject to certain conditions described below, into shares of the Company's common stock at an initial conversion rate of 44.7678 per \$1,000 principal amount of notes, which represented an initial conversion price of approximately \$22.34 per share, subject to adjustment. As of June 30, 2007, the Company is making the required interest payments on the *Convertible Notes* and no other changes in the balance or structure of the *Convertible Notes* has occurred.

In October 2005, the Company obtained stockholder approval of a net-share settlement feature that allows the Company to settle conversion of the *Convertible Notes* through a combination of cash and stock. Based on the provisions of Emerging Issues Task Force No. 90-19, *Convertible Bonds with Issuer Option to Settle for Cash upon Conversion* (EITF 90-19) and Emerging Issues Task Force No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled In, a Company's Own Stock* (EITF 00-19), the net-settlement feature is accounted for as convertible debt and is not subject to the provisions of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133). As a result of the net-settlement feature, the Company will be able to substantially reduce the number of shares issuable in the event of conversion of the *Convertible Notes* by repaying principal in cash instead of issuing shares of common stock for that amount. Additionally, the Company will not be required to include the underlying shares of common stock in the calculation of the Company's diluted weighted average shares outstanding for earnings per share until the Company's common stock price exceeds \$22.34.

The aggregate underwriting commissions and other debt issuance costs incurred with respect to the issuance of the *Convertible Notes* were \$3.4 million, which have been capitalized as debt issuance costs on the Company's consolidated statements of financial condition and are being amortized using the effective interest rate method over the term of the *Convertible Notes*.

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The Convertible Notes also contain a restricted convertibility feature that does not affect the conversion price of the Convertible Notes but, instead, places restrictions on a holder's ability to convert their Convertible Notes into shares of the Company's common stock. A holder may convert the Convertible Notes prior to March 19, 2010 only if one or more of the following conditions are satisfied:

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

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

the Company enters into specified corporate transactions; or

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

Holders may also surrender their Convertible Notes for conversion anytime on or after March 19, 2010 until the close of business on the trading day immediately preceding September 19, 2010, regardless of whether any of the foregoing conditions have been satisfied. Upon the satisfaction of any of the foregoing conditions on last day of a reporting period, or during the twelve months prior to September 19, 2010, the Company would write off to expense all remaining unamortized debt issuance costs in that period.

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

Convertible Notes Hedge Strategy. Concurrent with the sale of the Convertible Notes, the Company purchased call options to purchase from the counterparties an aggregate of 4,476,780 shares of the Company's common stock at a price of \$22.34 per share. The cost of the call options totaled \$27.4 million. The Company also sold warrants to the same counterparties to purchase from the Company an aggregate of 3,984,334 shares of the Company's common stock at a price of \$29.04 per share and received net proceeds from the sale of these warrants of \$11.6 million. Taken together, the call option and warrant agreements have the effect of increasing the effective conversion price of the Convertible Notes to \$29.04 per share. The call options and warrants must be settled in net shares, except in connection with certain termination events, in which case they would be settled in cash based on the fair market value of the instruments. On the date of settlement, if the market price per share of the Company's common stock is above \$29.04 per share, the Company will be required to deliver shares of its common stock representing the value of the call options and warrants in excess of \$29.04 per share.

The warrants have a strike price of \$29.04 and are generally exercisable at anytime. The Company issued and sold the warrants in a transaction exempt from the registration requirements of the Securities Act of 1933, as amended, because the offer and sale did not involve a public offering. There were no underwriting commissions or discounts in connection with the sale of the warrants. In accordance with EITF No. 00-19 and Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, the Company recorded the net call options and warrants as a reduction in additional paid in capital as of December 31, 2005, and will not recognize subsequent changes in fair value of the call options and warrants in its consolidated financial statements.

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Revolving Credit Facility

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

On February 27, 2007, the Company amended the *Revolving Credit Facility* to allow for the Company to buy back up to \$50 million of a combination of its common stock and Convertible Notes, subject to compliance with certain covenants and available borrowing capacity. The entire \$50 million may be used to repurchase common stock, but only \$25 million may be used to repurchase the Convertible Notes. This amendment also reset the Company's minimum net worth threshold.

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

Other provisions of the amended *Revolving Credit Facility* remain unchanged following the most recent amendment, and include:

Interest at a floating rate equal to, at the Company's option, either: (a) reserve adjusted LIBOR plus a spread that ranges from 175 to 225 basis points, depending on the Company's leverage; or (b) the higher of the federal funds rate then in effect plus a spread of 50 basis points or the prime rate then in effect.

An aggregate revolving commitment of \$200.0 million, (with an expansion feature to \$250.0 million) subject to borrowing base availability, with \$5.0 million sub-limits for swingline loans and letters of credit.

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

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

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

Collateralization of all assets of the Company.

At June 30, 2007, of the \$200.0 million commitment, the outstanding balance on the *Revolving Credit Facility* was \$122.7 million, which bore a weighted average interest rate of 7.35%. The aggregate borrowing base was \$200.0 million, of which \$77.3 million was available for future borrowings.

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The Company repaid in full the principal balance of the Secured Financing Facility at the end of 2006 and will make no further borrowings under that facility. Prior to May 7, 2007, the Company and the lender shared the residual collections, net of servicing fees paid to the Company. The residual collections paid to the lender were classified as contingent interest (Contingent Interest).

On May 7, 2007, the Company entered into an agreement with the lender under its Secured Financing Facility to eliminate all future Contingent Interest payments, for a one-time payment of \$16.9 million. This agreement released the lender's security interests in the remaining receivables originally financed under the Secured Financing Facility. This payment, less \$5.2 million accrued on the Company's balance sheet (\$11.7 million, or \$6.9 million after the effect of income taxes), is included in total other expense in the statements of operations for the three and six-month periods ended June 30, 2007. The charge reduced earnings per share by approximately \$0.30 for the three and six-month periods ended June 30, 2007. Subsequent to the second quarter of 2007, the Company will no longer record any Contingent Interest expense under the Secured Financing Facility in its statements of operations.

The following table summarizes interest expense associated with the Secured Financing Facility for the periods presented (*in thousands*):

| | Three Months Ended | | Six Months Ended | |
|--------------------------------|--------------------|------------------|------------------|------------------|
| | June 30, 2007 | June 30, 2006 | June 30, 2007 | June 30, 2006 |
| Stated interest | \$ | \$ 420 | \$ | \$ 897 |
| Contingent interest | 888 | 4,235 | 4,123 | 8,921 |
| Pay-off of contingent interest | 11,733 | | 11,733 | |
| Total interest expense | \$ 12,621 | \$ 4,655 | \$ 15,856 | \$ 9,818 |

Derivative Instruments

On April 11, 2007, the Company entered into two separate interest rate swap agreements intended to more effectively manage interest rates by establishing a set level of fixed rates associated with a portion of the borrowings under its Revolving Credit Facility. The first agreement is for a notional amount of \$25 million, a term of three years and a fixed interest rate of 4.99%. The second agreement is for a notional amount of \$25 million, a term of four years and a fixed interest rate of 5.01%. Giving effect to these hedges, the interest rate the Company will pay on \$50 million of the outstanding balance under the Revolving Credit Facility will be the fixed interest rates mentioned above plus the required credit spread, which ranges from 175 to 225 basis points.

SFAS No. 133 *Accounting for Derivative Instruments and Hedge Activities, as amended* (SFAS133), requires that the derivatives be recorded on the balance sheet as either an asset or liability measured at its fair value. Changes in the derivatives fair value must be recorded to earnings unless specific hedge accounting criteria has been met and the hedge is designated as an effective hedge. When these criteria are met, the change in fair value is recorded as other comprehensive income. From the inception of the hedging program, the Company has concluded that the criteria have been met and the hedges have been classified as effective cash flow hedges. Accordingly, for the quarter and six months ended June 30, 2007, the Company has recorded the change in fair value as other comprehensive income. As of June 30, 2007, the fair value of the hedges was \$0.4 million and is included in other assets and other comprehensive income.

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Capital Lease Obligations

The Company has capital lease obligations for certain computer equipment. These lease obligations require monthly payments aggregating approximately \$21,000 through November 2008 and have implicit interest rates ranging from 2.9% to 3.1%. Capital lease obligations outstanding as of June 30, 2007, and June 30, 2006 were \$0.3 million, and \$0.6 million, respectively.

Note 7: Income Taxes

The Company recorded an income tax benefit of \$0.6 million, reflecting an effective rate of 40.3% of pretax income for the three months ended June 30, 2007. The effective tax rate for the three months ended June 30, 2007 consists primarily of a benefit for Federal income taxes of 31.9% (which is net of a provision for state taxes of 3.1%), a benefit for State taxes of 8.8% and a provision for the effect of permanent book versus tax differences of 0.4%. For the three months ended June 30, 2006, the Company recorded an income tax provision of \$5.7 million, reflecting an effective rate of 43.3% of pretax income. The effective tax rate for the three months ended June 30, 2006, consists primarily of a provision for Federal income taxes of 31.9% (which is net of a benefit for State taxes of 3.1%), a provision for State taxes of 8.8%, the effect of permanent book versus tax differences of 0.1% and the effect of an anticipated adjustment related to an Internal Revenue tax audit of the Company's 2003 income tax return of 2.5%, which the Company concluded during the three months ended June 30, 2006 was probable.

The Company recorded an income tax provision of \$3.3 million, reflecting an effective rate of 40.8% of pretax income for the six months ended June 30, 2007. The effective tax rate for the six months ended June 30, 2007, consists primarily of a provision for Federal income taxes of 31.9% (which is net of a benefit for state taxes of 3.1%), a provision for State taxes of 8.8%, and the effect of permanent book versus tax differences of 0.1%. For the six months ended June 30, 2006, the Company recorded an income tax provision of \$8.9 million, reflecting an effective rate of 42.3% of pretax income. The effective tax rate for the six months ended June 30, 2006, consists primarily of a provision for Federal income taxes of 31.9% (which is net of a benefit for State taxes of 3.1%), a provision for State taxes of 8.8%, the effect of permanent book versus tax differences of 0.1% and the effect of an anticipated adjustment related to an Internal Revenue tax audit of the company's 2003 income tax return of 1.5%, which the Company concluded during the three months ended June 30, 2006 was probable.

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The following table summarizes the concentration of the Company's purchases by seller sorted by total aggregate costs for the six months ended June 30, 2007 and 2006, adjusted for put-backs, account recalls and replacements (*in thousands, except percentages*):

| | Concentration of Initial | | | |
|--------------------------|---------------------------------|----------|----------------------|----------|
| | Purchase Cost by Seller | | | |
| | For the Six Months Ended | | | |
| | June 30, 2007 | | June 30, 2006 | |
| | Cost | % | Cost | % |
| Seller 1 | \$ 32,142 | 37.1% | \$ 21,009 | 43.4% |
| Seller 2 | 12,041 | 13.9% | 10,331 | 21.4% |
| Seller 3 | 7,260 | 8.4% | 6,256 | 12.9% |
| Seller 4 | 6,939 | 8.0% | 4,543 | 9.4% |
| Seller 5 | 5,196 | 6.0% | 3,622 | 7.5% |
| Seller 6 | 5,066 | 5.9% | 1,286 | 2.7% |
| Seller 7 | 3,921 | 4.5% | 743 | 1.5% |
| Seller 8 | 3,164 | 3.7% | 563 | 1.2% |
| Seller 9 | 2,582 | 3.0% | | |
| Seller 10 | 2,469 | 2.9% | | |
| Other | 5,743 | 6.6% | | |
| | \$ 86,523 | 100.0% | \$ 48,353 | 100.0% |
| Adjustments ¹ | (130) | | (139) | |
| Purchases, net | \$ 86,393 | | \$ 48,214 | |

¹ Adjusted for put-backs, account recalls and replacements.

Note 9: Commitments and Contingencies**Litigation**

On October 18, 2004, Timothy W. Moser, a former officer of the Company, filed an action in the United States District Court for the Southern District of California against the Company, and certain individuals, including several of the Company's officers and directors. On February 14, 2005 the Company was served with an amended complaint in this action alleging defamation, intentional interference with contractual relations, breach of contract, breach of the covenant of good faith and fair dealing, intentional and negligent infliction of emotional distress and civil conspiracy arising out of certain statements in the Company's Registration Statement on Form S-1 originally filed in September 2003 and alleged to be included in the Company's Registration Statement on Form S-3 originally filed in May 2004. The amended complaint seeks injunctive relief, economic and punitive damages in an unspecified amount plus an award of profits allegedly earned by the defendants and alleged co-conspirators as a result of the alleged conduct, in addition to attorney's fees and costs. On May 2, 2006, the court denied the Company's special motion to strike pursuant to California's anti-SLAPP statute, denied in part and granted in part our motion to dismiss, denied a variety of *ex parte* motions and applications filed by the plaintiff and denied the plaintiff's motion for leave to conduct discovery or file supplemental briefing. The court granted the plaintiff 30 days in which to further amend his complaint, and on June 1, 2006, the plaintiff filed a second amended

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complaint in which he amended his claim for negligent infliction of emotional distress. On May 25, 2006, the Company filed a notice of appeal of the court's order denying the anti-SLAPP motion, which is pending. On June 16, 2006, the Company filed a motion to stay the case pending the outcome of the appeal. This motion was granted on March 27, 2007. On April 9, 2007, the plaintiff filed a motion requesting an accelerated early neutral evaluation conference, which the court denied on April 16, 2007. Management of the Company believes the claims are without merit and intends to vigorously defend the action. Although the outcome of this matter cannot be predicted with certainty, management does not currently believe that this matter will have a material adverse effect on the Company's consolidated financial position or results of operations.

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

On February 9, 2007, the Company's wholly-owned subsidiary, Midland Credit Management, Inc. (Midland), entered into a definitive joint stipulation of settlement and release (the Settlement Agreement) with the lead plaintiff in a proposed class action on behalf of herself and all others similarly situated to settle litigation filed against Midland in the San Diego County Superior Court, relating to claims under the California Labor Code. Pursuant to the Settlement Agreement, the claims brought in the class action against Midland would be settled for a maximum total payment (if all settlement class members submit valid claims) of \$1.1 million. Of this amount, approximately \$85,000 represents unpaid bonus overtime compensation alleged to be owed to the approximately 400 members of the class over a 4-year period, including employer taxes and statutory interest on such amounts. The balance represents a negotiated settlement of penalties allegedly owed to the class members under California law for the failure to pay the unpaid bonus overtime compensation, plaintiff's attorney's fees, and the costs of administering the settlement. The Settlement received final court approval on June 7, 2007. The final settlement payment amount, reflecting actual claims submitted, was \$0.9 million. Accordingly, in the quarter ended June 30, 2007, the Company has reversed \$0.2 million of the accrued expense to reflect the actual settlement.

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

Purchase Commitments

In June 2005, the Company entered into a forward flow agreement to purchase a minimum of \$3.0 billion in face value of credit card charge-offs over a five-year period at a fixed price. As of June 30, 2007, future minimum purchase commitments under this agreement are as follows (*amounts in thousands*):

| 2007 | 2008 | 2009 | 2010 | Total |
|----------|----------|----------|----------|-----------|
| \$16,980 | \$33,959 | \$33,959 | \$16,980 | \$101,878 |

The purchase commitment above assumes that the remaining commitment as of June 30, 2007 will be incurred ratably over the remaining term of such agreement.

Note 10: Securities Repurchase Program

On February 27, 2007, the Company's board of directors authorized a securities repurchase program under which the Company may buy back up to \$50 million of a combination of its common stock and Convertible Notes. The entire \$50 million may be used to repurchase common stock, but only \$25 million may be used to repurchase the Convertible Notes. The purchases may be made from time to time in the open market or through privately negotiated transactions and will be dependent upon various business and financial considerations. Securities repurchases are subject to compliance with applicable legal requirements and other factors. As of June 30, 2007, the Company has not repurchased any of its common stock or its Convertible Notes under this program.

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

This information should be read in conjunction with the condensed consolidated financial statements and the notes thereto included in Item 1 of Part I of this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2006 contained in our 2006 Annual Report on Form 10-K. The Form 10-K contains a general description of our industry and a discussion of recent trends affecting the industry. Certain statements herein may constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995 (the Reform Act), for which we claim the protection of the safe harbor of the Reform Act. See Part II, Item 1A Risk Factors for more discussion on our forward-looking statements.

Introduction

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

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

The following tables summarize the types of charged-off consumer receivable portfolios we purchased for the three and six months ended June 30, 2007 and 2006 (*in thousands*):

| | Three Months Ended | | Six Months Ended | |
|-------------|--------------------|------------------|------------------|------------------|
| | June 30, 2007 | June 30, 2006 | June 30, 2007 | June 30, 2006 |
| Credit card | \$ 35,666 | \$ 10,207 | \$ 80,261 | \$ 25,918 |
| Other | 5,471 | 11,055 | 6,262 | 22,435 |
| | \$ 41,137 | \$ 21,262 | \$ 86,523 | \$ 48,353 |

During the three months ended June 30, 2007, we invested \$41.1 million for portfolios with face values aggregating \$1.3 billion for an average purchase price of 3.1% of face value. This is a \$19.9 million increase, or 93.5%, in the amount invested, compared with the \$21.3 million invested during the three months ended June 30, 2006, to acquire portfolios with a face value aggregating \$0.6 billion for an average purchase price of 3.6% of face value.

During the six months ended June 30, 2007, we invested \$86.5 million for portfolios with face values aggregating \$3.9 billion for an average purchase price of 2.2% of face value. This is a \$38.1 million increase, or 78.9%, in the amount invested, compared with the \$48.4 million invested during the six months ended June 30, 2006, to acquire portfolios with a face value aggregating \$1.2 billion for an average purchase price of 4.2% of face value.

During the twelve months ended June 30, 2007, we invested \$182.5 million for portfolios with face values aggregating \$6.4 billion for an average purchase price of 2.9% of face value. This is a \$80.1 million increase, or 78.1%, in the amount invested, compared with the \$102.4 million invested during the twelve months ended June 30, 2006, to acquire portfolios with a face value aggregating \$2.9 billion for an average purchase price of 3.6% of face value.

Table of Contents**Collections by Channel**

During the three and six months ended June 30, 2007 and 2006, we utilized several business channels for the collection of charged-off credit card receivables and other charged-off receivables. The following tables summarize gross collections by collection channel (*in thousands*):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------------------|-----------------------------|-----------|---------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| Collection sites | \$ 32,516 | \$ 33,579 | \$ 66,511 | \$ 74,861 |
| Legal collections | 44,430 | 29,065 | 84,160 | 54,836 |
| Sales | 7,972 | 1,985 | 15,269 | 9,094 |
| Collection agencies | 7,686 | 13,951 | 16,503 | 26,915 |
| Other | 1,007 | 606 | 1,709 | 1,096 |
| Gross collections for the period | \$ 93,611 | \$ 79,186 | \$ 184,152 | \$ 166,802 |

Gross collections increased \$14.4 million, or 18.2%, to \$93.6 million during the three months ended June 30, 2007, from \$79.2 million during the three months ended June 30, 2006.

Gross collections increased \$17.4 million, or 10.4%, to \$184.2 million during the six months ended June 30, 2007, from \$166.8 million during the six months ended June 30, 2006.

Results of Operations

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

| | Three Months Ended June 30, | | | |
|--|-----------------------------|--------|-----------|--------|
| | 2007 | | 2006 | |
| Revenue | | | | |
| Revenue from receivable portfolios, net | \$ 64,021 | 95.2% | \$ 59,604 | 90.4% |
| Servicing fees and other related revenue | 3,207 | 4.8% | 6,329 | 9.6% |
| Total revenue | 67,228 | 100.0% | 65,933 | 100.0% |
| Operating expenses | | | | |
| Salaries and employee benefits | 16,064 | 23.9% | 16,306 | 24.7% |
| Stock-based compensation expense | 1,204 | 1.8% | 1,464 | 2.2% |
| Cost of legal collections | 21,159 | 31.5% | 12,944 | 19.6% |
| Other operating expenses | 6,239 | 9.3% | 5,655 | 8.6% |
| Collection agency commissions | 2,867 | 4.2% | 5,032 | 7.6% |
| General and administrative expenses | 4,232 | 6.3% | 3,300 | 5.0% |
| Depreciation and amortization | 840 | 1.2% | 968 | 1.5% |
| Total operating expenses | 52,605 | 78.2% | 45,669 | 69.2% |
| Income before other income (expense) and income taxes | 14,623 | 21.8% | 20,264 | 30.8% |
| Other income (expense) | | | | |
| Interest expense | (3,336) | (5.0%) | (3,102) | (4.7%) |
| Contingent interest expense | (888) | (1.3%) | (4,235) | (6.4%) |

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| | | | | |
|--|-----------------|---------------|-----------------|--------------|
| Pay-off of future contingent interest | (11,733) | (17.4%) | | |
| Other (expense) income | (42) | (0.1%) | 284 | 0.4% |
| Total other expense | (15,999) | (23.8%) | (7,053) | (10.7%) |
| (Loss) income before income taxes | (1,376) | (2.0%) | 13,211 | 20.1% |
| Benefit (provision) for income taxes | 555 | (0.8%) | (5,716) | (8.7%) |
| Net (loss) income | \$ (821) | (1.2%) | \$ 7,495 | 11.4% |

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| | Six Months Ended June 30, | | | |
|--|---------------------------|---------|------------|---------|
| | 2007 | | 2006 | |
| Revenue | | | | |
| Revenue from receivable portfolios, net | \$ 126,174 | 95.2% | \$ 117,178 | 92.7% |
| Servicing fees and other related revenue | 6,429 | 4.8% | 9,235 | 7.3% |
| Total revenue | 132,603 | 100.0% | 126,413 | 100.0% |
| Operating expenses | | | | |
| Salaries and employee benefits | 33,250 | 25.1% | 32,585 | 25.8% |
| Stock-based compensation expense | 2,005 | 1.5% | 2,845 | 2.2% |
| Cost of legal collections | 38,780 | 29.2% | 24,222 | 19.2% |
| Other operating expenses | 11,983 | 9.0% | 12,101 | 9.6% |
| Collection agency commissions | 6,161 | 4.7% | 9,645 | 7.6% |
| General and administrative expenses | 8,503 | 6.4% | 7,033 | 5.6% |
| Depreciation and amortization | 1,709 | 1.3% | 1,928 | 1.5% |
| Total operating expenses | 102,391 | 77.2% | 90,359 | 71.5% |
| Income before other income (expense) and income taxes | 30,212 | 22.8% | 36,054 | 28.5% |
| Other income (expense) | | | | |
| Interest expense | (6,256) | (4.7%) | (6,367) | (5.0%) |
| Contingent interest expense | (4,123) | (3.1%) | (8,921) | (7.1%) |
| Pay-off of future contingent interest | (11,733) | (8.9%) | | |
| Other income | 74 | 0.1% | 334 | 0.3% |
| Total other expense | (22,038) | (16.6%) | (14,954) | (11.8%) |
| Income before income taxes | 8,174 | 6.2% | 21,100 | 16.7% |
| Provision for income taxes | (3,338) | (2.5%) | (8,927) | (7.1%) |
| Net income | \$ 4,836 | 3.7% | \$ 12,173 | 9.6% |

Comparison of Results of Operations**Revenue**

Our revenue consists primarily of portfolio revenue and bankruptcy servicing revenue. Portfolio revenue is comprised of accretion revenue and zero basis revenue. Accretion revenue represents revenue derived from pools (quarterly groupings of purchased receivable portfolios) with a cost basis that has not been fully amortized. Revenue from pools with a remaining unamortized cost basis is accrued based on each pool's effective interest rate applied to each pool's remaining unamortized cost basis. The cost basis of each pool is increased by revenue earned and decreased by gross collections and impairments. The effective interest rate is the internal rate of return derived from the timing and amounts of actual cash received and anticipated future cash flow projections for each pool. All collections realized after the net book value of a portfolio has been fully recovered (Zero Basis Portfolios) are recorded as revenue (Zero Basis Revenue). We account for our investment in receivable portfolios utilizing the interest method in accordance with the provisions of the AICPA's Statement of Position 03-03, Accounting for Certain Debt Securities Acquired in a Transfer (SOP 03-03). Servicing fee revenue is revenue primarily associated with bankruptcy servicing fees earned from our subsidiary, Ascension Capital Group, Inc. (Ascension), a provider of bankruptcy services to the finance industry.

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The following table summarizes our portfolio revenue by revenue-to-collections percentage. The accrual basis portfolios from 1999 to 2003 represent pool groups with high internal rates of return and high revenue to collection percentages (*in thousands, except percentages*):

| | For the Three Months Ended | | | | For the Three Months Ended | | | | |
|------------------------------------|-----------------------------------|-----------|--------------------------|-----------------------------|-----------------------------------|-----------|--------------------------|-----------------------------|--|
| | June 30, 2007 | | | | June 30, 2006 | | | | |
| | Revenue to Collections Percentage | Revenue | Collections ¹ | Percentage of Total Revenue | Revenue to Collections Percentage | Revenue | Collections ¹ | Percentage of Total Revenue | |
| Zero Basis Portfolios | 100.0% | \$ 4,047 | \$ 4,047 | 6.3% | 100.0% | \$ 6,734 | \$ 6,734 | 11.3% | |
| 1999 2003 Accrual Basis Portfolios | 90.0% | 8,903 | 9,891 | 13.9% | 88.6% | 16,134 | 18,215 | 27.1% | |
| 2004 2005 Accrual Basis Portfolios | 70.5% | 27,815 | 39,463 | 43.5% | 70.1% | 32,065 | 45,772 | 53.8% | |
| 2006 Accrual Basis Portfolios | 64.6% | 15,508 | 24,006 | 24.2% | 56.4% | 4,671 | 8,281 | 7.8% | |
| 2007 Accrual Basis Portfolios | 48.2% | 7,748 | 16,067 | 12.1% | | | | | |
| Total | 68.5% | \$ 64,021 | \$ 93,474 | 100.0% | 75.4% | \$ 59,604 | \$ 79,002 | 100.0% | |

| | For the Six Months Ended | | | | For the Six Months Ended | | | | |
|------------------------------------|-----------------------------------|------------|--------------------------|-----------------------------|-----------------------------------|------------|--------------------------|-----------------------------|--|
| | June 30, 2007 | | | | June 30, 2006 | | | | |
| | Revenue to Collections Percentage | Revenue | Collections ¹ | Percentage of Total Revenue | Revenue to Collections Percentage | Revenue | Collections ¹ | Percentage of Total Revenue | |
| Zero Basis Portfolios | 100.0% | \$ 9,156 | \$ 9,156 | 7.3% | 100.0% | \$ 13,241 | \$ 13,240 | 11.3% | |
| 1999 2003 Accrual Basis Portfolios | 88.1% | 19,819 | 22,495 | 15.7% | 80.3% | 35,080 | 43,691 | 29.9% | |
| 2004 2005 Accrual Basis Portfolios | 66.3% | 53,965 | 81,410 | 42.8% | 63.3% | 63,371 | 100,056 | 54.1% | |
| 2006 Accrual Basis Portfolios | 67.0% | 32,961 | 49,223 | 26.1% | 58.0% | 5,486 | 9,464 | 4.7% | |
| 2007 Accrual Basis Portfolios | 47.6% | 10,273 | 21,602 | 8.1% | | | | | |
| Total | 68.6% | \$ 126,174 | \$ 183,886 | 100.0% | 70.4% | \$ 117,178 | \$ 166,451 | 100.0% | |

¹ Does not include amounts collected on behalf of third parties.

Total revenue was \$67.2 million for the three months ended June 30, 2007, an increase of \$1.3 million, or 2.0%, compared to total revenue of \$65.9 million for the three months ended June 30, 2006. Revenue, excluding Ascension's bankruptcy servicing fees of \$3.2 million, increased \$4.3 million, or 7.4%, to \$64.0 million. The increase in portfolio revenue was primarily the result of additional accretion revenue associated with higher purchasing volumes in the first and second quarter of 2007 compared to the same period in 2006, increased accretion revenue related to new operating initiatives and the net reversal of impairments taken in prior periods. The increase in revenue was partially offset by a greater portion of our revenues coming from our 2004 to 2007 portfolio purchases that have lower effective accretion rates than our 2003 and prior purchases, due to a more competitive pricing environment since 2004. During the three months ended June 30, 2007, we recorded a net impairment provision reversal of \$1.0 million compared to an impairment provision reversal of \$0.4 million during the same period in the prior year. Total revenue was \$132.6 million for the six months ended June 30, 2007, an increase of \$6.2 million, or 4.9%, compared to total revenue of \$126.4 million for the six months ended June 30, 2006. Revenue, excluding Ascension's bankruptcy servicing fees of \$6.4 million, increased \$8.9 million, or 7.6%, to \$126.2 million. The increase in portfolio revenue was primarily the result of additional accretion revenue associated with higher purchasing volumes in the first and second quarter of 2007 compared to the same period in 2006, increased accretion revenue associated with extending our collection forecast in the second quarter of 2006 from 60 months to 72 months, increased accretion revenue related to new operating initiatives and the net reversal of impairments taken in prior periods. The increase in revenue was partially offset by a greater portion of our revenues coming from our 2004 to 2007 portfolio purchases that have lower effective accretion rates than our 2003 and prior purchases, due to a more competitive pricing environment since 2004. During the six months ended June 30, 2007, we recorded a net impairment provision reversal of \$1.3 million compared to an impairment provision of \$0.1 million during the same period in the prior year.

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Revenue associated with bankruptcy servicing fees earned from Ascension, a provider of bankruptcy services to the finance industry, was \$3.2 million for the three months ended June 30, 2007, a decrease of \$3.0 million, or 49.5%, compared to Ascension revenue of \$6.2 million for the three months ended June 30, 2006. Revenue associated with bankruptcy servicing fees earned from Ascension, was \$6.4 million for the six months ended June 30, 2007, a decrease of \$2.7 million, or 30.3%, compared to Ascension revenue of \$9.1 million for the six months ended June 30, 2006. The decreases in Ascension revenue for the three and six months ended June 30, 2007, are due to the high volume of bankruptcy placements in October 2005 just prior to the effective date of the Bankruptcy Reform Act (the Act). Consistent with our revenue recognition policy, the revenue associated with the significant number of Chapter 7 bankruptcy placements in October 2005 was recognized during the three months ended June 30, 2006. Although bankruptcy placements have not returned to the levels experienced prior to the Act, they have increased from the low levels experienced in late 2005 and early 2006.

Operating Expenses

Total operating expenses were \$52.6 million for the three months ended June 30, 2007, an increase of \$6.9 million, or 15.2%, compared to total operating expenses of \$45.7 million for the three months ended June 30, 2006.

Total operating expenses were \$102.4 million for the six months ended June 30, 2007, an increase of \$12.0 million, or 13.3%, compared to total operating expenses of \$90.4 million for the six months ended June 30, 2006.

Operating expenses are explained in more detail as follows:

Salaries and employee benefits

Total salaries and employee benefits remained relatively flat, decreasing by \$0.2 million, or 1.5%, to \$16.1 million during the three months ended June 30, 2007, from \$16.3 million during the three months ended June 30, 2006.

Total salaries and employee benefits increased by \$0.7 million, or 2.0%, to \$33.3 million during the six months ended June 30, 2007, from \$32.6 million during the six months ended June 30, 2006. The increase was primarily the result of a \$0.9 million increase in salaries and wages related to annual salary increases, a \$0.5 million increase in severance expense, offset by a decrease of \$0.7 million in bonuses and other employee benefits.

Stock-based compensation expenses

Stock-based compensation expense decreased \$0.3 million, or 17.8% to \$1.2 million, for the three months ended June 30, 2007, compared to \$1.5 million for the three months ended June 30, 2006. Stock-based compensation expense decreased \$0.8 million, or 29.5% to \$2.0 million, for the six months ended June 30, 2007, compared to \$2.8 million for the six months ended June 30, 2006. The decreases were primarily the result of changes in assumptions used in calculating stock-based compensation for the three and six months ended June 30, 2007 compared to June 30, 2006. Statement of Financial Accounting Standards No. 123R, *Share-Based Payments*, requires us to analyze our assumptions used in valuing stock-based compensation and revise and implement new assumptions on an annual basis. The primary revision made in our 2007 assumptions was to use approximately five years to calculate the expected volatility and forfeitures rather than three years, which was used in 2006. See Note 3 to the condensed consolidated financial statements for a further discussion of stock-based compensation.

Table of Contents***Cost of legal collections***

The cost of legal collections increased \$8.2 million, or 63.5%, to \$21.2 million during the three months ended June 30, 2007, as compared to \$12.9 million during the three months ended June 30, 2006. These costs represent contingent fees paid to our nationwide network of attorneys and costs of litigation. The increase in the cost of legal collections was primarily the result of an increase of \$15.4 million, or 52.9%, in gross collections through our legal channel. Gross legal collections increased to \$44.4 million during the three months ended June 30, 2007, from \$29.1 million collected during the three months ended June 30, 2006. Cost of legal collections increased as a percent of gross collections through this channel to 47.6% during the three months ended June 30, 2007, from 44.5% during the three months ended June 30, 2006, primarily as a result of the payment of upfront court costs associated with legal collections.

The cost of legal collections increased \$14.6 million, or 60.1%, to \$38.8 million during the six months ended June 30, 2007, as compared to \$24.2 million during the six months ended June 30, 2006. The increase in the cost of legal collections was primarily the result of an increase of \$29.4 million, or 53.5%, in gross collections through our legal channel. Gross legal collections increased to \$84.2 million during the six months ended June 30, 2007, from \$54.8 million collected during the six months ended June 30, 2006. Cost of legal collections increased as a percent of gross collections through this channel to 46.1% during the six months ended June 30, 2007, from 44.2% during the six months ended June 30, 2006, primarily as a result of the payment of upfront court costs associated with legal collections.

Other operating expenses

Other operating expenses increased \$0.5 million, or 10.3%, to \$6.2 million during the three months ended June 30, 2007, from \$5.7 million during the three months ended June 30, 2006. The increase was primarily the result of an increase in the number of direct mail campaigns for our receivable portfolios offset by the decrease of Ascension's legal expense and decrease of amortization of deferred revenue. The cost of direct mail campaigns increased \$1.5 million, or 104.0%, to \$3.0 million during the three months ended June 30, 2007, compared to \$1.5 million during the three months ended June 30, 2006. Ascension's legal expense decreased \$0.6 million, or 66.3%, to \$0.2 million during the three months ended June 30, 2007. Amortization of deferred revenue decreased \$0.3 million, or 49.0%, to \$0.3 million during the three months ended June 30, 2007.

Other operating expenses decreased \$0.1 million, or 1.0%, to \$12.0 million during the six months ended June 30, 2007, from \$12.1 million during the six months ended June 30, 2006. The decrease was primarily the result of a decrease in Ascension's legal expense and a decrease in the amortization of deferred revenue offset by an increase in the number of direct mail campaigns for our receivable portfolios. Ascension's legal expense decreased \$0.6 million, or 44.7%, to \$0.7 million during the six months ended June 30, 2007. Amortization of deferred revenue decreased \$0.5 million, or 45.1%, to \$0.6 million during the six months ended June 30, 2007. The cost of direct mail campaigns increased \$1.1 million, or 25.8%, to \$5.2 million during the six months ended June 30, 2007, compared to \$4.1 million during the six months ended June 30, 2006.

Table of Contents***Collection agency commissions***

During the three months ended June 30, 2007, we incurred \$2.9 million in commissions to third party collection agencies, or 37.3% of the related gross collections of \$7.7 million, compared to \$5.0 million in commissions, or 36.1% of the related gross collections of \$14.0 million during the three months ended June 30, 2006. The decrease in commissions is consistent with the decrease in collections through this channel. The increase in the commission rate as a percentage of the related gross collections is primarily the result of the mix of accounts placed with the agencies. Commissions as a percentage of collections in this channel vary from period to period depending on, among other things, the time from charge-off of the accounts placed with an agency as freshly charged-off accounts have a lower commission rate.

During the six months ended June 30, 2007, we paid \$6.2 million in commissions to third party collection agencies, or 37.3% of the related gross collections of \$16.5 million, compared to \$9.6 million in commissions, or 35.8% of the related gross collections of \$26.9 million during the six months ended June 30, 2006. The decrease in commissions is consistent with the decrease in collections through this channel. The increase in the commission rate as a percentage of the related gross collections is primarily the result of the mix of accounts placed with the agencies.

General and administrative expenses

General and administrative expenses increased \$0.9 million, or 28.2%, to \$4.2 million during the three months ended June 30, 2007, from \$3.3 million during the three months ended June 30, 2006. The increase was primarily the result of approximately \$0.2 million of increased accounting and consulting service fees related to the filing of our 1999-2005 State tax returns, \$0.3 million of increased building rent and \$0.4 million related to increases in general corporate expenses.

General and administrative expenses increased \$1.5 million, or 20.9%, to \$8.5 million during the six months ended June 30, 2007, from \$7.0 million during the six months ended June 30, 2006. The increase was primarily the result of approximately \$0.7 million of increased accounting and consulting service fees related to the filing of our 1999-2005 State tax returns, \$0.4 million of increased building rent, and \$0.2 million in costs associated with the strategic alternatives process.

Depreciation and amortization

Depreciation and amortization expense decreased \$0.2 million, or 13.2%, to \$0.8 million during the three months ended June 30, 2007, from \$1.0 million during the three months ended June 30, 2006. Depreciation expense remained consistent at \$0.6 million during the three months ended June 30, 2007 and 2006. Amortization expense relating to intangible assets purchased from Ascension was \$0.3 million for the three months ended June 30, 2007, compared to \$0.4 million for the three months ended June 30, 2006.

Depreciation and amortization expense decreased \$0.2 million, or 11.4%, to \$1.7 million during the six months ended June 30, 2007, from \$1.9 million during the six months ended June 30, 2006. Depreciation expense remained consistent at \$1.1 million during the six months ended June 30, 2007 and 2006. Amortization expense relating to intangible assets acquired in conjunction with the acquisition of Ascension was \$0.5 million for the six months ended June 30, 2007, compared to \$0.8 million for the six months ended June 30, 2006.

Table of Contents**Interest expense**

Total interest expense increased \$8.6 million, or 117.5%, to \$15.9 million during the three months ended June 30, 2007, from \$7.3 million during the three months ended June 30, 2006.

Total interest expense increased \$6.8 million, or 44.6%, to \$22.1 million during the six months ended June 30, 2007 from \$15.3 million during the six months ended June 30, 2006.

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

| | For the Three Months Ended June 30, | | | |
|--|--|-----------------|-----------------|-----------------|
| | \$ | | | |
| | 2007 | 2006 | Change | % Change |
| Stated interest on debt obligations | \$ 2,951 | \$ 2,626 | \$ 325 | 12.4% |
| Amortization of loan fees and other loan costs | 385 | 476 | (91) | (19.1%) |
| Contingent interest expense | 888 | 4,235 | (3,347) | (79.0%) |
| Pay-off of future contingent interest | 11,733 | | 11,733 | |
| Total interest expense | \$ 15,957 | \$ 7,337 | \$ 8,620 | 117.5% |

| | For the Six Months Ended June 30, | | | |
|--|--|------------------|-----------------|-----------------|
| | \$ | | | |
| | 2007 | 2006 | Change | % Change |
| Stated interest on debt obligations | \$ 5,475 | \$ 5,330 | \$ 145 | 2.7% |
| Amortization of loan fees and other loan costs | 781 | 1,037 | (256) | (24.7%) |
| Contingent interest expense | 4,123 | 8,921 | (4,798) | (53.8%) |
| Pay-off of future contingent interest | 11,733 | | 11,733 | |
| Total interest expense | \$ 22,112 | \$ 15,288 | \$ 6,824 | 44.6% |

As of December 31, 2006, we repaid in full the principal balance of our Secured Financing Facility and will make no further borrowings under that facility. Prior to May 7, 2007, we shared with the lender the residual collections on purchases made under this facility, net of servicing fees paid to us. The residual collections paid to the lender were classified as contingent interest.

On May 7, 2007, we entered into an agreement with the lender under our Secured Financing Facility to eliminate all future contingent interest payments, for a one-time payment of \$16.9 million. This agreement released the lender's security interests in the remaining receivables originally financed under the Secured Financing Facility. This payment, less \$5.2 million accrued on our balance sheet (\$11.7 million, or \$6.9 million after the effect of income taxes), is included in total other expense in our statements of operations for the three and six-month periods ended June 30, 2007. The charge reduced earnings per share by approximately \$0.30 for the three and six-month periods ended June 30, 2007. Subsequent to the second quarter of 2007, we will no longer record any contingent interest expense under the Secured Financing Facility in our statements of operations.

We have financed portfolio purchases subsequent to December 31, 2004, using our Revolving Credit Facility, which does not require the sharing of residual collections with the lender. See Note 6 to the consolidated financial statements for a further discussion on our Revolving Credit Facility.

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Other income and expense

During the three months ended June 30, 2007, total other income and expense was other expense of less than \$0.1 million, compared to other income of \$0.3 million for the three months ended June 30, 2006. The expense was primarily attributable to additional expenses associated with our non-qualified employee benefit plan (NQP).

During the six months ended June 30, 2007, total other income was \$0.1 million, compared to other income of \$0.3 million for the six months ended June 30, 2006. The decrease in other income was primarily attributable to additional expenses associated with our NQP.

Provision for income taxes

During the three months ending June 30, 2007, we recorded an income tax benefit of \$0.6 million, reflecting an effective rate of 40.3% of pretax income. Our effective tax rate for the three months ended June 30, 2007, differed from the Federal statutory rate primarily due to the net effect of State taxes and the effect of permanent book versus tax differences. For the three months ended June 30, 2006, we recorded an income tax provision of \$5.7 million, reflecting an effective rate of 43.3% of pretax income. Our effective tax rate for the three months ended June 30, 2006, differed from the Federal statutory rate primarily due to the net effect of State taxes. The decrease in our effective tax rate was the result of the changing mix of permanent book versus tax differences relative to higher taxable income.

During the six months ended June 30, 2007, we recorded an income tax provision of \$3.3 million, reflecting an effective rate of 40.8% of pretax income. Our effective tax rate for the six months ended June 30, 2007, differed from the Federal statutory rate primarily due to the net effect of State taxes. For the six months ended June 30, 2006, we recorded an income tax provision of \$8.9 million, reflecting an effective rate of 42.3% of pretax income. Our effective tax rate for the six months ended June 30, 2006, differed from the Federal statutory rate primarily due to the net effect of State taxes, and an adjustment for a 2003 tax audit. The decrease in our effective tax rate was the result of the changing mix of permanent book versus tax differences relative to taxable income. See Note 7 to the consolidated financial statements for a further discussion of income taxes.

Table of Contents**Supplemental Performance Data****Cumulative Collections to Purchase Price Multiple**

The following table summarizes our purchases and related resulting gross collections per year of purchase (*in thousands, except multiples*):

| Purchase | Cumulative Collections through June 30, 2007 | | | | | | | | | | |
|--------------|--|--------------------|------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|---------------------|------------------|
| | Price ¹ | <2001 ⁴ | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | Total ² | CCM ³ |
| <1999 | \$ 41,117 ₄ | \$ 88,629 | \$ 22,545 | \$ 15,007 | \$ 7,546 | \$ 4,202 | \$ 2,042 | \$ 1,513 | \$ 573 | \$ 142,057 | 3.5 |
| 1999 | 48,712 | 29,163 | 19,174 | 16,259 | 11,508 | 8,654 | 5,157 | 3,513 | 1,169 | 94,597 | 1.9 |
| 2000 | 6,153 | 5,489 | 7,172 | 4,542 | 4,377 | 2,293 | 1,323 | 1,007 | 341 | 26,544 | 4.3 |
| 2001 | 38,186 | | 21,197 | 54,184 | 33,072 | 28,551 | 20,622 | 14,521 | 3,429 | 175,576 | 4.6 |
| 2002 | 61,501 | | | 48,322 | 70,227 | 62,282 | 45,699 | 33,694 | 9,054 | 269,278 | 4.4 |
| 2003 | 88,535 | | | | 59,038 | 86,958 | 69,932 | 55,131 | 16,328 | 287,387 | 3.2 |
| 2004 | 101,352 | | | | | 39,400 | 79,845 | 54,832 | 20,336 | 194,413 | 1.9 |
| 2005 | 192,887 | | | | | | 66,491 | 129,809 | 61,830 | 258,130 | 1.3 |
| 2006 | 142,152 | | | | | | | 42,354 | 49,224 | 91,578 | 0.6 |
| 2007 | 86,262 | | | | | | | | 21,602 | 21,602 | 0.3 |
| Total | \$ 806,857 | \$ 123,281 | \$ 70,088 | \$ 138,314 | \$ 185,768 | \$ 232,340 | \$ 291,111 | \$ 336,374 | \$ 183,886 | \$ 1,561,162 | 1.9 |

¹ Adjusted for put-backs, account recalls, purchase price rescissions, and the impact of an acquisition in 2000.

² Cumulative collections from inception through June 30, 2007.

³ Cumulative Collections Multiple (CCM) collections to date as a multiple of purchase price.

⁴ From inception to December 31, 1998.

Total Estimated Collections to Purchase Price Multiple

The following table summarizes our purchases, resulting historical gross collections, and estimated remaining gross collections by year of purchase (*in thousands, except multiples*):

| Purchase | Historical | Estimated | Total | Total Estimated Gross Collections to Purchase Price | |
|--------------------|--------------------------|---------------------|-------------------|---|------------|
| | Gross | Remaining Gross | Estimated Gross | | |
| Price ¹ | Collections ² | Collections | Collections | | |
| <1999 | \$ 41,117 ₃ | \$ 142,057 | \$ 396 | \$ 142,453 | 3.5 |
| 1999 | 48,712 | 94,597 | 2,267 | 96,864 | 2.0 |
| 2000 | 6,153 | 26,544 | 689 | 27,233 | 4.4 |
| 2001 | 38,186 | 175,576 | 13,938 | 189,514 | 5.0 |
| 2002 | 61,501 | 269,278 | 21,746 | 291,024 | 4.7 |
| 2003 | 88,535 | 287,387 | 41,261 | 328,648 | 3.7 |
| 2004 | 101,352 | 194,413 | 69,142 | 263,555 | 2.6 |
| 2005 | 192,887 | 258,130 | 243,943 | 502,073 | 2.6 |
| 2006 | 142,152 | 91,578 | 260,940 | 352,518 | 2.5 |
| 2007 ⁴ | 86,262 | 21,602 | 176,738 | 198,340 | 2.3 |
| Total | \$ 806,857 | \$ 1,561,162 | \$ 831,060 | \$ 2,392,222 | 3.0 |

-
- ¹ Adjusted for put-backs, account recalls, purchase price rescissions, and the impact of an acquisition in 2000.
 - ² Cumulative collections from inception through June 30, 2007.
 - ³ From inception to December 31, 1998.
 - ⁴ As of April 1, 2007, initial collection forecasts for portfolio purchases were extended from 54/60 months to 72 months. Purchases from the first quarter of 2007 continue to be forecasted over 54/60 months until these portfolios are greater than six months from the date of purchase, at which time a 72 months forecast will be used.

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Estimated Remaining Gross Collections by Year of Purchase

The following table summarizes our estimated remaining gross collections by year of purchase (*in thousands*):

| | Estimated Remaining Gross Collections by Year of Purchase | | | | | | | Total |
|--------------|---|-------------------|-------------------|-------------------|------------------|------------------|-----------------|-------------------|
| | 2007 ¹ | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | |
| <1999 | \$ 251 | \$ 134 | \$ 11 | \$ | \$ | \$ | \$ | \$ 396 |
| 1999 | 818 | 1,209 | 240 | | | | | 2,267 |
| 2000 | 221 | 336 | 121 | 11 | | | | 689 |
| 2001 | 2,961 | 4,709 | 3,191 | 1,888 | 890 | 254 | 45 | 13,938 |
| 2002 | 7,421 | 10,024 | 2,323 | 1,240 | 551 | 187 | | 21,746 |
| 2003 | 12,826 | 19,839 | 8,596 | | | | | 41,261 |
| 2004 | 17,089 | 25,633 | 17,529 | 8,891 | | | | 69,142 |
| 2005 | 52,022 | 79,968 | 53,912 | 40,949 | 16,950 | 124 | 18 | 243,943 |
| 2006 | 43,046 | 73,686 | 53,485 | 41,929 | 32,951 | 15,843 | | 260,940 |
| 2007 | 25,170 | 53,962 | 40,902 | 29,099 | 18,656 | 7,035 | 1,914 | 176,738 |
| Total | \$ 161,825 | \$ 269,500 | \$ 180,310 | \$ 124,007 | \$ 69,998 | \$ 23,443 | \$ 1,977 | \$ 831,060 |

¹ 2007 amount consists of six months data from July 1, 2007 to December 31, 2007.

Unamortized Balances of Portfolios

The following table summarizes the remaining unamortized balances of our purchased receivable portfolios by year of purchase as of June 30, 2007 (*in thousands, except percentages*):

| | Unamortized | | Unamortized | |
|---------------|----------------------------|--------------------|----------------------------|--|
| | Balance as of | Purchase | Balance as a Percentage of | Unamortized Balance as a Percentage of Total |
| | June 30, 2007 ² | Price ¹ | Purchase Price | Percentage of Total |
| 2002 | \$ 3,031 | \$ 61,501 | 4.9% | 0.9% |
| 2003 | 6,756 | 88,535 | 7.6% | 2.1% |
| 2004 | 27,113 | 101,352 | 26.8% | 8.3% |
| 2005 | 105,984 | 192,887 | 54.9% | 32.4% |
| 2006 | 109,770 | 142,152 | 77.2% | 33.5% |
| 2007 | 74,932 | 86,262 | 86.9% | 22.8% |
| Totals | \$ 327,586 | \$ 672,689 | 48.7% | 100.0% |

¹ Purchase price refers to the cash paid to a seller to acquire a portfolio less the purchase price refunded by a seller due to the return of non-compliant accounts (also defined as put-backs) less the purchase price for accounts that were sold at the time of purchase to another debt purchaser.

² For purposes of this table, unamortized balance includes cash collections from sales entered into subsequent to the original purchase; sales that occurred at the time of purchase are excluded.

Table of Contents**Collections by Channel**

During the three and six months ended June 30, 2007 and 2006, we utilized several business channels for the collection of charged-off credit card receivables and other charged-off receivables. The following tables summarize gross collections by collection channel (*in thousands*):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------------------|--------------------------------|-----------|------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| Collection sites | \$ 32,516 | \$ 33,579 | \$ 66,511 | \$ 74,861 |
| Legal collections | 44,430 | 29,065 | 84,160 | 54,836 |
| Sales | 7,972 | 1,985 | 15,269 | 9,094 |
| Collection agencies | 7,686 | 13,951 | 16,503 | 26,915 |
| Other | 1,007 | 606 | 1,709 | 1,096 |
| Gross collections for the period | \$ 93,611 | \$ 79,186 | \$ 184,152 | \$ 166,802 |

External Collection Channels and Related Direct Costs

| | Legal Collections | | | | Collection Agencies | | | |
|---------------------------------|-------------------------------------|--------|-----------|--------|-------------------------------------|--------|-----------|--------|
| | Three Months Ended June 30, 2007 | | 2006 | | Three Months Ended June 30, 2007 | | 2006 | |
| Collections | \$ 44,430 | 100.0% | \$ 29,065 | 100.0% | \$ 7,686 | 100.0% | \$ 13,951 | 100.0% |
| Commissions | 12,964 | 29.1% | 9,352 | 32.2% | 2,867 | 37.3% | 5,032 | 36.1% |
| Court cost expense ¹ | 8,029 | 18.1% | 3,568 | 12.3% | | | | |
| Other ² | 166 | 0.4% | 24 | 0.1% | | | | |
| Total Costs | \$ 21,159 | 47.6% | \$ 12,944 | 44.6% | \$ 2,867 | 37.3% | \$ 5,032 | 36.1% |

| | Legal Collections | | | | Collection Agencies | | | |
|---------------------------------|-----------------------------------|--------|-----------|--------|-----------------------------------|--------|-----------|--------|
| | Six Months Ended June 30, 2007 | | 2006 | | Six Months Ended June 30, 2007 | | 2006 | |
| Collections | \$ 84,160 | 100.0% | \$ 54,836 | 100.0% | \$ 16,503 | 100.0% | \$ 26,915 | 100.0% |
| Commissions | 24,847 | 29.5% | 17,627 | 32.2% | 6,161 | 37.3% | 9,645 | 35.8% |
| Court cost expense ¹ | 13,562 | 16.1% | 6,544 | 11.9% | | | | |
| Other ² | 371 | 0.5% | 51 | 0.1% | | | | |
| Total Costs | \$ 38,780 | 46.1% | \$ 24,222 | 44.2% | \$ 6,161 | 37.3% | \$ 9,645 | 35.8% |

¹ In connection with our agreement with contracted attorneys, we advance certain out-of-pocket court costs. We capitalize these costs in our consolidated financial statements and provide a reserve and corresponding court cost expense for the costs that we believe will be ultimately uncollectible.

² Other, consists primarily of costs related to counter claims.

Changes in Investment in Receivable Portfolios

Revenue related to our investment in receivable portfolios consists of two components. First, revenue from those portfolios that have a remaining book value and are accounted for on the accrual basis (Accrual Basis Portfolios), and second, revenue from those portfolios that have fully recovered their cost basis for which every dollar of gross collections is recorded entirely as Zero Basis Revenue (Zero Basis Portfolios).

If the amount and timing of future cash collections on a pool of receivables are not reasonably estimable, we account for such portfolios on the cost recovery method (Cost Recovery Portfolios). The accounts in these portfolios have different risk characteristics than those included in other

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portfolios acquired during the same quarter, or the necessary information was not available to estimate future cash flows and, accordingly, they were not aggregated with other portfolios. Under the cost recovery method of accounting, no income is recognized until the purchase price of a Cost Recovery Portfolio has been fully recovered. At June 30, 2007, there were no portfolios accounted for using the cost recovery method.

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The following tables summarize the changes in the balance of the investment in receivable portfolios and the proportion of revenue recognized as a percentage of collections (*in thousands, except percentages*):

| | For the Three Months Ended June 30, 2007 | | | |
|--|--|--------------------------------|-----------------------------|------------|
| | Accrual Basis Portfolios | Cost Recovery Portfolios | Zero Basis Portfolios | Total |
| Balance, beginning of period | \$ 316,522 | \$ | \$ | \$ 316,522 |
| Purchases of receivable portfolios | 41,137 | | | 41,137 |
| Gross collections ¹ | (89,426) | | (3,827) | (93,253) |
| Basis adjustments | (621) | | | (621) |
| Revenue recognized ¹ | 58,928 | | 3,827 | 62,755 |
| Impairment reversals, net | 1,046 | | | 1,046 |
| Balance, end of period | \$ 327,586 | \$ | \$ | \$ 327,586 |
| Revenue as a percentage of collections | 67.1% | 0.0% | 100.0% | 68.4% |

| | For the Three Months Ended June 30, 2006 | | | |
|--|--|--------------------------------|-----------------------------|------------|
| | Accrual Basis Portfolios | Cost Recovery Portfolios | Zero Basis Portfolios | Total |
| Balance, beginning of period | \$ 248,529 | \$ 3,880 | \$ | \$ 252,409 |
| Purchases of receivable portfolios | 21,262 | | | 21,262 |
| Gross collections ¹ | (71,382) | (888) | (6,368) | (78,638) |
| Basis adjustments | (835) | | (1) | (836) |
| Revenue recognized ¹ | 52,437 | | 6,369 | 58,806 |
| Impairment reversals, net | 434 | | | 434 |
| Balance, end of period | \$ 250,445 | \$ 2,992 | \$ | \$ 253,437 |
| Revenue as a percentage of collections | 74.1% | 0.0% | 100.0% | 75.3% |

| | For the Six Months Ended June 30, 2007 | | | |
|--|--|--------------------------------|-----------------------------|------------|
| | Accrual Basis Portfolios | Cost Recovery Portfolios | Zero Basis Portfolios | Total |
| Balance, beginning of period | \$ 300,348 | \$ | \$ | \$ 300,348 |
| Purchases of receivable portfolios | 86,523 | | | 86,523 |
| Gross collections ¹ | (174,730) | | (8,664) | (183,394) |
| Basis adjustments | (1,574) | | | (1,574) |
| Revenue recognized ¹ | 115,756 | | 8,664 | 124,420 |
| Impairment reversals, net | 1,263 | | | 1,263 |
| Balance, end of period | \$ 327,586 | \$ | \$ | \$ 327,586 |
| Revenue as a percentage of collections | 67.0% | 0.0% | 100.0% | 68.5% |

| | For the Six Months Ended June 30, 2006 | | | |
|--|--|--------------------------------|-----------------------------|-------|
| | Accrual Basis Portfolios | Cost Recovery Portfolios | Zero Basis Portfolios | Total |

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| | | | | |
|--|------------|----------|----------|------------|
| Balance, beginning of period | \$ 255,299 | \$ 1,034 | \$ | \$ 256,333 |
| Purchases of receivable portfolios | 44,730 | 3,623 | | 48,353 |
| Gross collections ¹ | (151,540) | (1,665) | (12,516) | (165,721) |
| Basis adjustments | (1,982) | | (2) | (1,984) |
| Revenue recognized ¹ | 103,792 | | 12,518 | 116,310 |
| Impairment reversals, net | 146 | | | 146 |
| Balance, end of period | \$ 250,445 | \$ 2,992 | \$ | \$ 253,437 |
| Revenue as a percentage of collections | 68.6% | 0.0% | 100.0% | 70.3% |

¹ For accrual basis portfolios, the weighted average annualized effective interest rate is the accrual rate utilized in recognizing revenue on our Accrual Basis Portfolios. This rate represents the monthly internal rate of return, which has been annualized utilizing the simple interest method. The monthly internal rate of return is determined based on the timing and amounts of actual cash received to date and the anticipated future cash flow projections for each pool.

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As of June 30, 2007, we had \$327.6 million in investment in receivable portfolios. This balance will be amortized based upon current projections of cash collections in excess of revenue applied to the principal balance. The estimated amortization of the investment in receivable portfolio balance is as follows (*in thousands*):

| For the Years Ended December 31, | Amortization |
|---|---------------------|
| 2007 ¹ | \$ 43,581 |
| 2008 | 89,250 |
| 2009 | 68,673 |
| 2010 | 61,882 |
| 2011 | 44,907 |
| 2012 | 17,829 |
| 2013 | 1,464 |
| Total | \$ 327,586 |

¹ 2007 amount consists of six months data from July 1, 2007 to December 31, 2007.

Analysis of Changes in Revenue

The following tables analyze the components of the increase in revenue from our receivable portfolios for the three and six months ended June 30, 2007, compared to the three and six months ended June 30, 2006 (*in thousands, except percentages*):

| Variance Component | For The Three Months Ended June 30, | | | |
|---|--|-------------|---------------|-----------------|
| | 2007 | 2006 | Change | Variance |
| Average portfolio balance | \$ 307,645 | \$ 249,868 | \$ 57,777 | \$ 12,225 |
| Weighted average effective interest rate ¹ | 78.0% | 84.6% | (6.6%) | (5,122) |
| Zero basis revenue | \$ 3,827 | \$ 6,369 | | (2,542) |
| Retained interest revenue | \$ 220 | \$ 364 | | (144) |
| Total variance | | | | \$ 4,417 |

| Variance Component | For The Six Months Ended June 30, | | | |
|---|--|-------------|---------------|-----------------|
| | 2007 | 2006 | Change | Variance |
| Average portfolio balance | \$ 305,119 | \$ 250,300 | \$ 54,819 | \$ 22,764 |
| Weighted average effective interest rate ¹ | 76.7% | 83.1% | (6.4%) | (9,683) |
| Zero basis revenue | \$ 8,664 | \$ 12,518 | | (3,854) |
| Retained interest revenue | \$ 491 | \$ 722 | | (231) |
| Total variance | | | | \$ 8,996 |

¹ For Accrual Basis Portfolios, the weighted average annualized effective interest rate is the accrual rate utilized in recognizing revenue on our accrual basis portfolios. This rate represents the monthly internal rate of return, which has been annualized utilizing the simple interest method. The monthly internal rate of return is determined based on the timing and amounts of actual cash received to date and the anticipated future cash flow projections for each pool.

Table of Contents**Purchases by Quarter**

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

| Quarter | # of Accounts | Face Value | Purchase Price | Forward Flow Allocation ² |
|----------------------|------------------|------------|-------------------|--|
| Q1 2004 | 400 | \$ 786,398 | \$ 17,248 | \$ |
| Q2 2004 | 296 | 758,877 | 19,031 | |
| Q3 2004 | 365 | 721,237 | 20,967 | |
| Q4 2004 | 530 | 1,195,090 | 46,128 | |
| Q1 2005 | 513 | 530,047 | 19,523 | |
| Q2 2005 ¹ | 2,773 | 3,675,277 | 121,939 | |
| Q3 2005 | 434 | 381,508 | 14,151 | 2,330 |
| Q4 2005 | 1,568 | 1,326,216 | 39,941 | 1,935 |
| Q1 2006 | 673 | 558,574 | 27,091 | 2,403 |
| Q2 2006 | 837 | 594,190 | 21,262 | 2,118 |
| Q3 2006 | 1,469 | 1,081,892 | 32,334 | 2,939 |
| Q4 2006 | 814 | 1,439,826 | 63,600 | 3,184 |
| Q1 2007 | 1,434 | 2,510,347 | 45,386 | 3,539 |
| Q2 2007 | 1,042 | 1,341,148 | 41,137 | 2,949 |

¹ Purchase price for Q2 2005 includes a \$0.9 million cost adjustment associated with the finalization of the Jefferson Capital purchase price allocation.

² Allocation of the forward flow asset to the cost basis of receivable portfolio purchases.

Purchases by Paper Type

The following tables summarize the types of charged-off consumer receivable portfolios we purchased for the three and six months ended June 30, 2007 and 2006 (*in thousands*):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------|-----------------------------|-----------|---------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| Credit card | \$ 35,666 | \$ 10,207 | \$ 80,261 | \$ 25,918 |
| Other | 5,471 | 11,055 | 6,262 | 22,435 |
| | \$ 41,137 | \$ 21,262 | \$ 86,523 | \$ 48,353 |

Liquidity and Capital Resources**Overview**

Historically, we have met our cash requirements by utilizing our cash flows from operations, bank borrowings and equity offerings. Our primary cash requirements have included the purchase of receivable portfolios, operational expenses, the payment of interest and the repayment of principal on bank borrowings and tax payments. Our strong operating performance has resulted in an increase in stockholders' equity to \$159.7 million as of June 30, 2007, from \$151.1 million as of December 31, 2006. In addition, we had an unrestricted cash balance of \$4.5 million at June 30, 2007, after borrowing \$27.0 million and purchasing \$80.0 million (excluding the \$6.5 million allocation of the forward flow asset) in receivable portfolios.

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

| | Six months ended | |
|---|------------------|------------------|
| | 2007 | June 30, 2006 |
| Net cash (used in) provided by operating activities | \$ (9,195) | \$ 16,149 |
| Net cash (used in) provided by investing activities | (20,365) | 6,763 |
| Net cash provided by (used in) financing activities | 23,264 | (19,860) |

On December 31, 2004, our Secured Financing Facility expired. All of our portfolio purchases are now funded with cash or financed under our \$200.0 million Revolving Credit Facility. Unlike our Secured Financing Facility, the Revolving Credit Facility does not require us to share with the lender the residual collections on the portfolios financed. See Note 6 to the consolidated financial statements for a further discussion on our Revolving Credit Facility, Secured Financing Facility and Contingent Interest.

On May 7, 2007, we entered into an agreement with the lender under our Secured Financing Facility to eliminate all future Contingent Interest payments, for the one-time payment of \$16.9 million. As a result, beginning in May 2007, we are no longer obligated to make future Contingent Interest payments under this facility.

Operating Cash Flows

Net cash used in operating activities was \$9.2 million for the six months ended June 30, 2007, compared to \$16.1 million in net cash provided by operating activities for the six months ended June 30, 2006. The reduction in net cash provided by operating activities was primarily due to an increase of \$19.5 million in cash basis operating expenses and the payment of the one time Contingent Interest payment discussed above, offset by an increase in gross collections. The increase in operating expenses was primarily volume-related, driven by our growth in collections, as well as changes in our collection strategies.

Historically we have been able to generate positive operating cash flow by maintaining our gross collections performance. Excluding the effects of the one time Contingent Interest payment, cash used in operations would have resulted in cash provided by operations of \$7.7 million. Gross collections for the six months ended June 30, 2007, grew \$17.4 million, or 10.4%, to \$184.2 million, from \$166.8 million for the six months ended June 30, 2006.

Interest payments were \$28.7 million for the six months ended June 30, 2007, compared to \$18.7 million for the six months ended June 30, 2006. The increase in interest expense was due to the one-time Contingent Interest payment discussed above.

Investing Cash Flows

Net cash used in investing activities was \$20.4 million for the six months ended June 30, 2007, compared to \$6.8 million net cash provided by investing activities for the six months ended June 30, 2006.

The cash flows used in investing activities for the six months ended June 30, 2007 are primarily related to cash receivable portfolio purchases of \$80.0 million (\$86.5 million of gross purchases less our forward flow allocation of \$6.5 million), offset by gross collection proceeds applied to the principal of our receivable portfolios in the amount of \$59.0 million. The cash flows provided by investing activities for the six months ended June 30, 2006 are primarily related to cash receivable portfolio purchases of \$43.8 million (\$48.3 million of gross purchases less our forward flow allocation of \$4.5 million), offset by gross collection proceeds applied to the principal of our receivable portfolios in the amount of \$49.4 million.

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Capital expenditures for fixed assets acquired with internal cash flows were \$0.9 million and \$0.8 million for the six months ended June 30, 2007 and 2006, respectively.

Financing Cash Flows

Net cash provided by (used in) financing activities was \$23.3 million and \$(19.9) million for the six months ended June 30, 2007 and 2006, respectively.

The cash provided by financing activities during the six months ended June 30, 2007 reflects \$27.0 million in borrowings, offset by \$4.0 million in repayments under our Revolving Credit Facility. The cash provided by financing activities during the six months ended June 30, 2006, reflects \$25.1 million in repayments of principal, offset by \$4.5 million in borrowings under our Revolving Credit Facility. The increase in borrowings for the six months ended June 30, 2007 was directly related to the increase in receivable portfolio purchases discussed above.

Future Contractual Cash Obligations

The following table summarizes our future contractual cash obligations as of June 30, 2007 (*in thousands*):

| | Payments Due by Period | | | | |
|---|------------------------|------------------|-------------------|-------------------|-----------------|
| | Less Than | 1 | 3 | 3 | More Than |
| | Total | 1 Year | Years | Years | 5 Years |
| Capital lease obligations | \$ 341 | \$ 250 | \$ 91 | \$ | \$ |
| Operating leases | 9,794 | 1,903 | 2,634 | 2,186 | 3,071 |
| Employment agreements | 385 | 385 | | | |
| Revolving Credit Facility | 122,669 | | 122,669 | | |
| Contractual interest on derivative instruments | 8,331 | 2,500 | 4,791 | 1,040 | |
| 3.375% Convertible Senior Notes | 100,000 | | | 100,000 | |
| Contractual interest on 3.375% Convertible Senior Notes | 10,969 | 3,375 | 6,750 | 844 | |
| Portfolio forward flow agreement | 101,878 | 33,959 | 67,919 | | |
| Total contractual cash obligations | \$ 354,367 | \$ 42,372 | \$ 204,854 | \$ 104,070 | \$ 3,071 |

Our Revolving Credit Facility has a remaining term of 2.9 years and to the extent that a balance is outstanding on our Revolving Credit Facility, it would be due in May 2010. Interest on the Revolving Credit Facility is variable and is not included in this table. The outstanding balance on our Revolving Credit Facility as of June 30, 2007, was \$122.7 million. The portfolio forward flow agreement represents estimated payments under our five-year portfolio purchase forward flow agreement entered into on June 7, 2005. For additional information on our debt, see Note 6 to the consolidated financial statements. Also, for additional information on purchase commitments see Note 9 to the consolidated financial statements.

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We are in compliance with all covenants under our financing arrangements and, excluding the effects of the one-time payment of \$16.9 million to eliminate all future Contingent Interest payments (this payment, less amounts accrued on our balance sheet, resulted in a charge to our statement of operations of \$6.9 million after the effect of income taxes), we have achieved twenty-two consecutive quarters of positive net income. We believe that we have sufficient liquidity to fund our operations for at least the next twelve months, given our expectation of continued positive cash flows from operations, our cash and cash equivalents of \$4.5 million as of June 30, 2007, and \$77.3 million in borrowing capacity and borrowing base availability under our Revolving Credit Facility as of June 30, 2007.

Off Balance Sheet Arrangements

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

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

For quantitative and qualitative disclosures about market risk affecting Encore, see Item 7A, Quantitative and Qualitative Disclosures About Market Risk, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, which is incorporated herein by reference. Our exposure to market risk has not changed materially since December 31, 2006.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic reports filed with the Securities and Exchange Commission (SEC) is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and management accordingly is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

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

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

On October 18, 2004, Timothy W. Moser, one of our former officers, filed an action in the United States District Court for the Southern District of California against us, and certain individuals, including several of our officers and directors. On February 14, 2005, we were served with an amended complaint in this action alleging defamation, intentional interference with contractual relations, breach of contract, breach of the covenant of good faith and fair dealing, intentional and negligent infliction of emotional distress and civil conspiracy arising out of certain statements in our Registration Statement on Form S-1 originally filed in September 2003 and alleged to be included in our Registration Statement on Form S-3 originally filed in May 2004. The amended complaint seeks injunctive relief, economic and punitive damages in an unspecified amount plus an award of profits allegedly earned by the defendants and alleged co-conspirators as a result of the alleged conduct, in addition to attorney's fees and costs. On May 2, 2006, the court denied our special motion to strike pursuant to California's anti-SLAPP statute, denied in part and granted in part our motion to dismiss, denied a variety of *ex parte* motions and applications filed by the plaintiff and denied the plaintiff's motion for leave to conduct discovery or file supplemental briefing. The court granted the plaintiff 30 days in which to further amend his complaint, and on June 1, 2006, the plaintiff filed a second amended complaint in which he amended his claim for negligent infliction of emotional distress. On May 25, 2006, we filed a notice of appeal of the court's order denying the anti-SLAPP motion, which is pending. On June 16, 2006, we filed a motion to stay the case pending the outcome of the appeal. This motion was granted on March 27, 2007. On April 9, 2007, the plaintiff filed a motion requesting an accelerated early neutral evaluation conference, which the court denied on April 16, 2007. Our management believes the claims are without merit and intends to vigorously defend the action. Although the outcome of this matter cannot be predicted with certainty, management does not currently believe that this matter will have a material adverse effect on our consolidated financial position or results of operations.

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

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

Item 1A. Risk Factors

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

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

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

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

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

We may not be able to collect sufficient amounts on our receivable portfolios to recover our costs and fund our operations;

We may purchase portfolios that contain unprofitable accounts;

The statistical model we use to project remaining cash flows from our receivable portfolios may prove to be inaccurate, which could result in reduced revenues or the recording of an impairment charge if we do not achieve the collections forecasted by our model;

Our industry is highly competitive, and we may be unable to continue to compete successfully with businesses that may have greater resources than we have;

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

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

We may be unable to meet our future liquidity requirements;

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

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

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

Government regulation may limit our ability to recover and enforce the collection of receivables;

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

A significant portion of our collections relies upon our success in individual lawsuits brought against consumers and ability to collect on judgments in our favor;

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We are subject to ongoing risks of litigation, including individual and class actions under consumer credit, collections, employment, securities and other laws;

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

We are dependent on our management team for the adoption and implementation of our strategies, and the loss of their services could have a material adverse effect on our business;

We may not be able to hire and retain enough sufficiently trained employees to support our operations, and/or we may experience high rates of personnel turnover;

We may not be able to manage our growth effectively;

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

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

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

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

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For more information about these risks, see the discussion under Part I, Item 1A Risk Factors of our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 filed with the Securities and Exchange Commission, which is incorporated herein by reference.

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

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

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Item 6. Exhibits

| Exhibit No. | Description |
|--------------------|---|
| 3.1 | Bylaws of Encore Capital Group, Inc., as amended through May 1, 2007 (incorporated by reference to Exhibit 3.1 to Form 8-K filed May 3, 2007). |
| 10.1 | Consent and Amendment No. 4, dated as of May 7, 2007, to Credit Agreement, dated as of June 7, 2005, by and among Encore Capital Group, Inc., the financial institutions listed therein, and JPMorgan Chase Bank, National Association, as Administrative Agent (incorporated by reference to Exhibit 10.3 to Form 10-Q filed May 8, 2007). |
| 31.1 | Certification of the Principal Executive Officer pursuant to rule 13-14(a) under the Securities Exchange Act of 1934 (filed herewith). |
| 31.2 | Certification of the Principal Financial Officer pursuant to rule 13-14(a) under the Securities Exchange Act of 1934 (filed herewith). |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley act of 2002 (filed herewith). |

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ENCORE CAPITAL GROUP, INC.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ENCORE CAPITAL GROUP, INC.

By: /s/ Paul Grinberg
Paul Grinberg
Executive Vice-President,
Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)

Date: August 8, 2007

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