

ENCORE CAPITAL GROUP INC

Form 10-Q

October 28, 2009

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2009

OR

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

COMMISSION FILE NUMBER: 000-26489

ENCORE CAPITAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

8875 Aero Drive, Suite 200

San Diego, California
(Address of principal executive offices)

48-1090909
(IRS Employer
Identification No.)

92123
(Zip code)

(877) 445 - 4581

(Registrant's telephone number, including area code)

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(Not Applicable)

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

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

Class	Outstanding at October 21, 2009
Common Stock, \$0.01 par value	23,180,747 shares

Table of Contents

ENCORE CAPITAL GROUP, INC.

INDEX TO FORM 10-Q

	Page
<u>PART I FINANCIAL INFORMATION</u>	1
<u>Item 1 Condensed Consolidated Financial Statements (Unaudited)</u>	1
<u>Condensed Consolidated Statements of Financial Condition</u>	1
<u>Condensed Consolidated Statements of Income</u>	2
<u>Condensed Consolidated Statements of Stockholders' Equity</u>	3
<u>Condensed Consolidated Statements of Cash Flows</u>	4
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	5
<u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
<u>Supplemental Performance Data</u>	34
<u>Liquidity and Capital Resources</u>	43
<u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u>	45
<u>Item 4 Controls and Procedures</u>	45
<u>PART II OTHER INFORMATION</u>	46
<u>Item 1 Legal Proceedings</u>	46
<u>Item 1A Risk Factors</u>	48
<u>Item 6 Exhibits</u>	50
<u>SIGNATURES</u>	51

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

(In Thousands, Except Par Value Amounts)

(Unaudited)

	September 30, 2009	December 31, 2008 Adjusted
Assets		
Cash and cash equivalents	\$ 6,940	\$ 10,341
Accounts receivable, net	3,211	1,757
Investment in receivable portfolios, net	534,656	461,346
Deferred court costs	27,710	28,335
Property and equipment, net	8,698	6,290
Prepaid income tax		7,935
Forward flow asset		10,302
Other assets	4,414	5,049
Goodwill	15,985	15,985
Identifiable intangible assets, net	1,268	1,739
Total assets	\$ 602,882	\$ 549,079
Liabilities and stockholders equity		
Liabilities:		
Accounts payable and accrued liabilities	\$ 19,775	\$ 18,204
Income taxes payable	3,256	
Deferred tax liabilities, net	15,545	15,108
Deferred revenue and purchased servicing obligation	5,675	5,203
Debt	324,394	303,655
Other liabilities	2,306	3,483
Total liabilities	370,951	345,653
Commitments and contingencies		
Stockholders equity:		
Convertible preferred stock, \$.01 par value, 5,000 shares authorized, no shares issued and outstanding		
Common stock, \$.01 par value, 50,000 shares authorized, 23,159 shares and 23,053 shares issued and outstanding as of September 30, 2009, and December 31, 2008, respectively	232	231
Additional paid-in capital	101,677	98,521
Accumulated earnings	131,437	106,795
Accumulated other comprehensive loss	(1,415)	(2,121)
Total stockholders equity	231,931	203,426
Total liabilities and stockholders equity	\$ 602,882	\$ 549,079

See accompanying notes to unaudited condensed consolidated financial statements

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

(In Thousands, Except Per Share Amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
		Adjusted		Adjusted
Revenue				
Revenue from receivable portfolios, net	\$ 76,448	\$ 62,557	\$ 222,688	\$ 192,900
Servicing fees and other related revenue	3,938	3,816	12,179	11,047
Total revenue	80,386	66,373	234,867	203,947
Operating expenses				
Salaries and employee benefits (excluding stock-based compensation expense)	14,411	14,963	43,130	45,503
Stock-based compensation expense	1,261	860	3,335	3,182
Cost of legal collections	26,092	25,390	84,665	69,525
Other operating expenses	6,034	6,018	18,612	17,656
Collection agency commissions	5,795	2,996	13,483	10,808
General and administrative expenses	7,280	4,864	20,074	13,905
Depreciation and amortization	652	674	1,895	2,162
Total operating expenses	61,525	55,765	185,194	162,741
Income before other (expense) income and income taxes	18,861	10,608	49,673	41,206
Other (expense) income				
Interest expense	(3,970)	(5,140)	(12,201)	(15,171)
Gain on repurchase of convertible notes, net			3,268	707
Other income (expense)	61	(32)	(11)	341
Total other expense	(3,909)	(5,172)	(8,944)	(14,123)
Income before income taxes	14,952	5,436	40,729	27,083
Provision for income taxes	(5,948)	(2,408)	(16,087)	(11,142)
Net income	\$ 9,004	\$ 3,028	\$ 24,642	\$ 15,941
Weighted average shares outstanding:				
Basic	23,225	23,029	23,177	23,009
Diluted	24,199	23,675	23,936	23,531
Earnings per share:				
Basic	\$ 0.39	\$ 0.13	\$ 1.06	\$ 0.69
Diluted	\$ 0.37	\$ 0.13	\$ 1.03	\$ 0.68

See accompanying notes to unaudited condensed consolidated financial statements

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

(Unaudited, In Thousands)

	Common Stock			Accumulated Earnings	Accumulated Other Comprehensive (Loss) Income	Total Equity	Comprehensive Income
	Shares	Par	Additional Paid-In Capital				
Balance at December 31, 2008, Adjusted	23,053	\$ 231	\$ 98,521	\$ 106,795	\$ (2,121)	\$ 203,426	
Net income				24,642		24,642	24,642
Other comprehensive income:							
Unrealized gain on cash flow hedge, net of tax					706	706	706
Exercise of stock options and issuance of share-based awards	106	1	(137)			(136)	
Stock-based compensation			3,335			3,335	
Tax provision related to stock option exercises			(42)			(42)	
Balance at September 30, 2009	23,159	\$ 232	\$ 101,677	\$ 131,437	\$ (1,415)	\$ 231,931	\$ 25,348

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)

	Nine Months Ended September 30,	
	2009	2008 Adjusted
Operating activities:		
Net Income	\$ 24,642	\$ 15,941
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,895	2,162
Amortization of loan costs and debt discount	3,100	4,751
Stock-based compensation expense	3,335	3,182
Gain on repurchase of convertible notes, net	(3,268)	(707)
Deferred income tax expense	437	825
Tax provision from stock-based payment arrangements	42	4
Provision for impairment on receivable portfolios, net	14,323	15,993
Changes in operating assets and liabilities		
Other assets	(1,623)	1,091
Deferred court costs	625	(6,674)
Prepaid income tax and income tax payable	11,149	9,920
Deferred revenue and purchased service obligation	472	999
Accounts payable, accrued liabilities and other liabilities	840	(2,203)
Net cash provided by operating activities	55,969	45,284
Investing activities:		
Purchases of receivable portfolios, net of forward flow allocation	(205,378)	(160,940)
Collections applied to investment in receivable portfolios, net	126,019	95,144
Proceeds from put-backs of receivable portfolios	2,028	2,610
Purchases of property and equipment	(3,626)	(2,139)
Net cash used in investing activities	(80,957)	(65,325)
Financing activities:		
Proceeds from revolving credit facility	85,500	57,000
Repayment of revolving credit facility	(41,500)	(32,169)
Repurchase of convertible notes	(22,262)	(3,500)
Proceeds from exercise of stock options	123	84
Tax provision from stock-based payment arrangements	(42)	(4)
Repayment of capital lease obligations	(232)	(208)
Net cash provided by financing activities	21,587	21,203
Net (decrease) increase in cash	(3,401)	1,162
Cash and cash equivalents, beginning of period	10,341	8,676
Cash and cash equivalents, end of period	\$ 6,940	\$ 9,838

Supplemental disclosures of cash flow information:

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Cash paid for interest	\$ 9,568	\$ 10,928
Income tax payment	\$ 4,859	\$ 1,158
Supplemental schedule of non-cash investing and financing activities:		
Fixed assets acquired through capital lease	\$ 224	\$ 201
Allocation of forward flow asset to acquired receivable portfolios	\$ 10,302	\$ 5,561

See accompanying notes to unaudited condensed consolidated financial statements

Table of Contents

ENCORE CAPITAL GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

Encore Capital Group, Inc. (*Encore*), through its subsidiaries (collectively, the *Company*), is a systems-driven purchaser and manager of charged-off consumer receivable portfolios and, through its wholly owned subsidiary Ascension Capital Group, Inc. (*Ascension*), a provider of bankruptcy services to the finance industry. The Company acquires its receivable portfolios at deep discounts from their face values using its proprietary valuation process that is based on the consumer attributes of the underlying accounts. Based upon the Company's ongoing analysis of these accounts, it employs a dynamic mix of collection strategies to maximize its return on investment. The receivable portfolios the Company purchases consist primarily of unsecured, charged-off domestic consumer credit card, auto deficiency and telecom receivables purchased from national financial institutions, major retail credit corporations, telecom companies and resellers of such portfolios. Acquisitions of receivable portfolios are financed by operations and by borrowings from third parties. See Note 7 for further discussion of the Company's debt.

Financial Statement Preparation

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

In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the Company's consolidated results of operations, financial position and cash flows. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008. Operating results for interim periods are not necessarily indicative of operating results for an entire fiscal year. Further, in connection with the condensed consolidated financial statements and in accordance with the recently issued Financial Accounting Standard Board (*FASB*) Accounting Standards Codification (*ASC*) Topic 855,

Subsequent Events (prior authoritative literature: Statement of Financial Accounting Standard No. 165 *Subsequent Events*), the Company evaluated subsequent events after the balance sheet date of September 30, 2009 through October 28, 2009, the date of the filing of these condensed consolidated financial statements.

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

Principles of Consolidation

The Company's condensed consolidated financial statements include the assets, liabilities and operating results of its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Change in Accounting Principle

Effective January 1, 2009, the Company retrospectively applied the provisions of FASB ASC Subtopic 470-20 (*Subtopic 470-20*) *Debt with Conversion and Other Options* (prior authoritative literature: FASB Staff Position APB 14-1 *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*) to account for its outstanding convertible senior notes. As a result, prior years' consolidated financial statements have been retrospectively adjusted. See Note 12 for additional information on the application of this accounting principle.

Reclassification

The prior year's consolidated statement of cash flows has been changed to the indirect method, to conform to the current year's presentation. Additionally, certain reclassifications have been made to the consolidated financial statements to conform to the current year's presentation.

Table of Contents***Earnings per Share***

Basic earnings per share (EPS) is calculated by dividing net earnings available to common stockholders by the weighted average number of shares of common stock outstanding. Common stock outstanding includes shares of common stock and restricted stock units for which no future service is required as a condition to the delivery of the underlying common stock. Diluted EPS includes the determinants of basic EPS and, in addition, reflects the dilutive effect of the common stock deliverable pursuant to stock options and to restricted stock units for which future service is required as a condition to the delivery of the underlying common stock. Employee stock options to purchase approximately 995,000 and 1,484,000 shares of common stock were outstanding during the three and nine months ended September 30, 2009, respectively, and employee stock options to purchase approximately 1,159,000 and 1,246,000 shares of common stock were outstanding during the three and nine months ended September 30, 2008, respectively, but not included in the computation of diluted earnings per share because the effect on diluted earnings per share would be anti-dilutive.

New Accounting Pronouncements

On July 1, 2009, the FASB officially launched the FASB Accounting Standards Codification, which has become the single official source of authoritative, nongovernmental U.S. Generally Accepted Accounting Principles (GAAP), in addition to guidance issued by the Securities and Exchange Commission. The codification supersedes all prior FASB, AICPA, EITF, and related literature. The codification, which is effective for interim and annual periods ending after September 15, 2009, is organized into approximately 90 accounting topics. The FASB no longer issues new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, amendments to the codification are made by issuing Accounting Standards Updates. The Company has incorporated the current codification in its form 10-Q.

In December 2008, the FASB released FSP FAS 132(R)-1, *Employers Disclosures about Postretirement Benefit Plan Assets* (Subtopic 715-20 *Defined Benefit Plans* under the FASB's codification). This FSP amends Statement of Financial Accounting Standard No. 132R to provide guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. This FSP is effective for financial statements issued for fiscal years ending after December 15, 2009. The Company expects to adopt this new standard and its required disclosures in its consolidated financial statements for the fiscal year ending December 31, 2009.

In June 2009, the FASB issued FAS No. 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140*. This pronouncement has not yet been incorporated into the FASB's codification. This standard will require more information about transferred financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. This standard is effective at the start of a company's first fiscal year beginning after November 15, 2009, or January 1, 2010, for companies reporting earnings on a calendar-year basis. The Company is currently analyzing the impact of this statement, if any, to its consolidated financial statements.

In August 2009, the FASB issued Accounting Standards Update No. 2009-05, *Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value*, which provides guidance on how to measure liabilities at fair value in circumstance in which a quoted price in an active market for the identical liability is not available. This update is effective for the first reporting period, including interim periods, beginning after issuance. The Company has no liabilities that are governed by this update but will apply its provisions in the future as applicable.

In October 2009, the FASB issued Accounting Standards Update No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force*, which establishes a selling price hierarchy for determining the selling price of a deliverable, and eliminates the residual method of allocation. This update requires the arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. This update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently analyzing the impact of this update, if any, to its consolidated financial statements.

Note 2: Fair Value Measurement

On January 1, 2008, the Company adopted the provisions of ASC Topic 820 (Topic 820) *Fair Value Measurements and Disclosures* (prior authoritative literature: Statement of Financial Accounting Standard No. 157, *Fair Value Measurements*) for financial assets and liabilities. On January 1, 2009, the Company adopted the provisions of Topic 820 for non-financial assets and non-financial liabilities that are recognized and disclosed at fair value on a nonrecurring basis. Topic 820 defines fair value, provides guidance for measuring fair value and requires certain disclosures. It does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements.

Table of Contents

Topic 820 utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

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

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

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

The Company's financial instruments consist of the following:

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

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

Financial instruments measured at fair value	Fair Value Hierarchy	As of September 30, 2009		As of December 31, 2008	
		Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	Level 1	\$ 6,940	\$ 6,940	\$ 10,341	\$ 10,341
Cash flow hedging instruments	Level 2	(2,306)	(2,306)	(3,483)	(3,483)

The fair value of cash and cash equivalents approximates their respective carrying value. Cash flow hedging instruments, which are considered over-the-counter derivatives, are also carried at their fair values. The Company's fair value estimate for such derivative instruments incorporates quoted market prices at the balance sheet date from the counter party using significant observable inputs and is considered a level 2 fair value measurement. As of September 30, 2009, the Company did not have any financial instruments carried at fair value that required level 3 measurement.

Financial instruments not required to be carried at fair value

Topic 820 requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The Company is required to estimate the fair value of financial instruments when it is practical to do so.

Borrowings under the Company's Revolving Credit Facility are carried at historical cost, adjusted for additional borrowings less principal repayments, which approximates fair value. The Company's Convertible Notes are carried at historical cost, adjusted for repurchases and debt discount. The fair value estimate incorporates quoted market prices at the balance sheet date, which was determined to be approximately \$41.0 million and \$51.4 million as of September 30, 2009 and December 31, 2008, respectively. For investment in receivable portfolios, there is no active market or observable inputs for the fair value estimation. The Company considers it not practical to attempt to estimate the fair value of such financial instruments due to the excessive costs that would be incurred in doing so.

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

Note 3: Stock-Based Compensation

On March 9, 2009, the Board of Directors approved an amendment and restatement of the 2005 Stock Incentive Plan (2005 Plan) which was originally adopted on March 30, 2005, for Board members, employees, officers, and executives of, and consultants and advisors to, the Company. The amendment and restatement of the 2005 Plan increased by 2,000,000 shares the maximum number of shares of the Company's common stock that may be issued or subject to awards under the plan, established a new 10-year term for the plan and made certain other amendments. The 2005 Plan amendment was approved by the Company's stockholders on June 9, 2009. The 2005 Plan provides for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, and performance-based

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awards to eligible individuals. The amended 2005 Plan allows the granting of an aggregate of 3,500,000 shares of the Company's common stock for awards, plus the number of ungranted shares of stock that were available for future awards under the prior 1999 Equity Participation Plan (1999 Plan). In addition, shares subject to options granted under either the 1999 Plan or the 2005 Plan that terminate or expire without being exercised will become available for grant under the 2005 Plan. The benefits provided under these plans are share-based compensation subject to the provisions of ASC Topic 718 (Topic 718) *Compensation - Stock Compensation* (prior authoritative literature: Statement of Financial Accounting Standard No. 123R, *Share-Based Payment*).

Table of Contents

In accordance with Topic 718, compensation expense is recognized only for those shares expected to vest, based on the Company's historical experience and future expectations. For the nine months ended September 30, 2009, approximately \$3.3 million was recognized as stock-based compensation expense.

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

Stock Options

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

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

The fair value of options granted is estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions:

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Weighted average fair value of options granted	\$ 4.91	\$ 5.37
Risk free interest rate	2.1%	3.0%
Dividend yield	0.0%	0.0%
Volatility factor of the expected market price of the Company's common stock	57.0%	46.0%
Weighted-average expected life of options	5 Years	5 Years

Unrecognized estimated compensation cost related to stock options as of September 30, 2009, was \$4.4 million, which is expected to be recognized over a weighted-average period of approximately 2.6 years.

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

	Number of Shares	Option Price Per Share	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2008	2,139,503	\$ 0.35 - \$20.09	\$ 9.14	
Granted	797,500	2.89 - 13.17	9.33	
Cancelled/forfeited	(78,383)	10.92 - 16.19	12.17	
Exercised	(19,511)	1.00 - 10.92	6.33	
Outstanding at September 30, 2009	2,839,109	\$ 0.35 - \$20.09	\$ 9.10	\$ 13,829
Exercisable at September 30, 2009	1,819,594	\$ 0.35 - \$20.09	\$ 8.70	\$ 10,126

The total intrinsic value of options exercised during the nine months ended September 30, 2009 and 2008 was \$0.1 million and \$0.3 million, respectively. As of September 30, 2009, the weighted-average remaining contractual life of options outstanding and options exercisable was 6.23 years and 4.48 years, respectively.

Restricted Stock Units

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Under the Company's 2005 Plan, certain employees and directors are eligible to receive restricted stock units. In accordance with Topic 718, the fair value of restricted stock units is equal to the closing price of the Company's common stock on the date of issuance. The total number of restricted stock unit awards expected to vest is adjusted by estimated forfeiture rates. As of September 30, 2009, 88,825 of the non-vested shares are expected to vest over their remaining terms of approximately one to three years based on certain performance goals (Performance-Based Awards). The fair value of the Performance-Based Awards is expensed over the expected vesting period based on our forfeiture assumptions. If performance goals are not expected to be met, the compensation expense previously recognized would be reversed. No reversals of compensation expense related to the Performance-Based Awards have been made as of September 30, 2009. The remaining 615,999 non-vested shares are not performance-based, and will vest over their remaining terms of approximately one to four years of service.

Table of Contents

For the nine months ended September 30, 2009, restricted stock unit activity and related information are as follows:

Restricted Stock Units	Non-Vested Shares	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2008	628,752	\$ 11.18
Awarded	275,655	\$ 5.82
Vested	(149,337)	\$ 11.12
Cancelled/forfeited	(50,246)	\$ 10.85
 Non-vested at September 30, 2009	 704,824	 \$ 9.12

Unrecognized estimated compensation cost related to restricted stock units as of September 30, 2009, was \$3.0 million, which is expected to be recognized over a weighted-average period of approximately 2.5 years. The fair value of restricted stock units vested for the nine months ended September 30, 2009 and 2008 was \$1.1 million and \$0.2 million, respectively.

Note 4: Investment in Receivable Portfolios, Net

In accordance with the provisions of FASB ASC Subtopic 310-30 (Subtopic 310-30) *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (prior authoritative literature: AICPA's Statement of Position 03-3, *Accounting for Certain Debt Securities Acquired in a Transfer*), 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 Subtopic 310-30 in the first quarter of 2005 were aggregated by quarter of purchase.

In compliance with Subtopic 310-30, the Company accounts for its investments in consumer receivable portfolios using either the interest method or the cost recovery method. The interest method applies an effective interest rate, or IRR, to the cost basis of the pool, which remains unchanged throughout the life of the pool, unless there is an increase in subsequent, expected cash flows. Subsequent increases in expected cash flows are generally recognized prospectively through an upward adjustment of the pool's IRR over its remaining life. Subsequent decreases in expected cash flows do not change the IRR, but are recognized as an impairment of the cost basis of the pool, and are reflected in the consolidated statements of income as a reduction in revenue, with a corresponding valuation allowance, offsetting the investment in receivable portfolios in the consolidated statements of financial condition.

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

If the amount and timing of future cash collections on a pool of receivables are not reasonably estimable, the Company accounts for such portfolios on the cost recovery method as Cost Recovery Portfolios. The accounts in these portfolios have different risk characteristics than those included in other portfolios acquired during the same quarter, or the necessary information was not available to estimate future cash flows and, accordingly, they were not aggregated with other portfolios. Under the cost recovery method of accounting, no income is recognized until the purchase price of a Cost Recovery Portfolio has been fully recovered. As of September 30, 2009, there were five portfolios accounted for using the cost recovery method, consisting of \$0.5 million in net book value of investment in receivable portfolios, representing all of the healthcare portfolios that the Company had acquired. In September 2007, the Company decided to exit its healthcare purchasing and collection activities. At that time, the Company anticipated either selling these healthcare portfolios or placing the underlying accounts with external agencies for collections. The Company no longer anticipates a sale of these receivable portfolios and has placed them with external collection agencies. Since the Company is no longer actively collecting on these accounts internally, it has classified them as Cost Recovery Portfolios. The \$0.5 million net book value reflects the value the Company expects to realize through the collection activities of the external agencies.

Accretable yield represents the amount of revenue the Company expects to generate over the remaining life of its existing investment in receivable portfolios based on estimated future cash flows. Total accretable yield is the difference between future estimated collections and the

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current carrying value of a portfolio. All estimated cash flows on portfolios where the cost basis has been fully recovered are classified as zero basis cash flows.

Table of Contents

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

	Nine Months Ended September 30, 2009		
	Accretable Yield	Estimate of Zero Basis Cash Flows	Total
Beginning balance at December 31, 2008	\$ 592,825	\$ 8,337	\$ 601,162
Revenue recognized, net	(69,775)	(2,500)	(72,275)
Additions on existing portfolios	5,715	1,032	6,747
Additions for current purchases	81,917		81,917
Balance at March 31, 2009	\$ 610,682	\$ 6,869	\$ 617,551
Revenue recognized, net	(71,576)	(2,389)	(73,965)
(Reductions) additions on existing portfolios	(15,399)	2,614	(12,785)
Additions for current purchases	106,771		106,771
Balance at June 30, 2009	\$ 630,478	\$ 7,094	\$ 637,572
Revenue recognized, net	(74,335)	(2,113)	(76,448)
(Reductions) additions on existing portfolios	(12,805)	511	(12,294)
Additions for current purchases	104,569		104,569
Balance at September 30, 2009	\$ 647,907	\$ 5,492	\$ 653,399

	Nine Months Ended September 30, 2008		
	Accretable Yield	Estimate of Zero Basis Cash Flows	Total
Beginning balance at December 31, 2007	\$ 486,652	\$ 13,002	\$ 499,654
Revenue recognized, net	(61,510)	(2,558)	(64,068)
Reductions on existing portfolios	(50,898)	(1,015)	(51,913)
Additions for 12 months curve extension	67,287		67,287
Additions for current purchases	112,780		112,780
Balance at March 31, 2008	\$ 554,311	\$ 9,429	\$ 563,740
Revenue recognized, net	(63,652)	(2,623)	(66,275)
(Reductions) additions on existing portfolios	(3,206)	1,598	(1,608)
Additions for current purchases	79,159		79,159
Balance at June 30, 2008	\$ 566,612	\$ 8,404	\$ 575,016
Revenue recognized, net	(60,298)	(2,259)	(62,557)
(Reductions) additions on existing portfolios	(11,736)	2,752	(8,984)
Additions for current purchases	106,525		106,525
Balance at September 30, 2008	\$ 601,103	\$ 8,897	\$ 610,000

During the three months ended September 30, 2009, the Company purchased receivable portfolios with a face value of \$2.2 billion for \$77.7 million, or a purchase cost of 3.6% of face value. The estimated future collections at acquisition for these portfolios amounted to \$181.3 million. During the nine months ended September 30, 2009, the Company purchased receivable portfolios with a face value of \$5.5 billion for \$215.7 million, or a purchase cost of 4.0% of face value. The estimated future collections at acquisition for these portfolios amounted to \$522.9 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 September 30, 2009 and 2008, approximately \$2.1 million and \$2.3 million were recognized as Zero Basis Revenue, respectively. During the nine months ended September 30, 2009 and 2008, approximately \$7.0 million and \$7.4 million

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were recognized as Zero Basis Revenue, respectively.

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

Table of Contents

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

	For the Three Months Ended September 30, 2009			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 506,155	\$ 553	\$	\$ 506,708
Purchases of receivable portfolios	77,734			77,734
Gross collections ⁽¹⁾	(123,498)	(25)	(2,113)	(125,636)
Put-backs and recalls ⁽²⁾	(598)			(598)
Revenue recognized	78,680		2,100	80,780
(Impairment) impairment reversals, net	(4,345)		13	(4,332)
Balance, end of period	\$ 534,128	\$ 528	\$	\$ 534,656
Revenue as a percentage of collections ⁽³⁾	63.7%	0.0%	99.4%	64.3%

	For the Three Months Ended September 30, 2008			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 413,256	\$ 1,303	\$	\$ 414,559
Purchases of receivable portfolios	66,107			66,107
Gross collections ⁽¹⁾	(95,349)	(89)	(2,259)	(97,697)
Put-backs and recalls ⁽²⁾	(562)	(1)		(563)
Revenue recognized ⁽⁴⁾	67,566		2,259	69,825
Impairment, net ⁽⁴⁾	(7,268)			(7,268)
Balance, end of period	\$ 443,750	\$ 1,213	\$	\$ 444,963
Revenue as a percentage of collections ⁽³⁾	70.9%	0.0%	100.0%	71.5%

	For the Nine Months Ended September 30, 2009			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 460,598	\$ 748	\$	\$ 461,346
Purchases of receivable portfolios	215,680			215,680
Gross collections ⁽¹⁾	(355,812)	(220)	(6,998)	(363,030)
Put-backs and recalls ⁽²⁾	(2,024)		(4)	(2,028)
Revenue recognized	230,054		6,957	237,011
(Impairment) impairment reversals, net	(14,368)		45	(14,323)
Balance, end of period	\$ 534,128	\$ 528	\$	\$ 534,656
Revenue as a percentage of collections ⁽³⁾	64.7%	0.0%	99.4%	65.3%

	For the Nine Months Ended September 30, 2008			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	\$ 390,564	\$ 1,645	\$	\$ 392,209
Purchases of receivable portfolios	166,501			166,501
Gross collections ⁽¹⁾	(296,178)	(419)	(7,440)	(304,037)

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Put-backs and recalls ⁽²⁾	(2,597)	(13)		(2,610)
Revenue recognized ⁽⁴⁾	201,453		7,440	208,893
Impairment, net ⁽⁴⁾	(15,993)			(15,993)
Balance, end of period	\$ 443,750	\$ 1,213	\$	\$ 444,963
Revenue as a percentage of collections ⁽³⁾	68.0%	0.0%	100.0%	68.7%

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

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

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

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

Table of Contents

The following table summarizes the change in the valuation allowance for investment in receivable portfolios during the nine months ended September 30, 2009 (*in thousands*):

	Valuation Allowance
Balance at December 31, 2008	\$ 57,152
Provision for impairment losses	5,580
Reversal of prior allowance	(153)
Balance at March 31, 2009	\$ 62,579
Provision for impairment losses	4,722
Reversal of prior allowance	(158)
Balance at June 30, 2009	\$ 67,143
Provision for impairment losses	4,855
Reversal of prior allowance	(523)
Balance at September 30, 2009	\$ 71,475

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		Nine Months Ended	
	September 30, 2009	2008	September 30, 2009	2008
Collection sites	\$ 45,122	\$ 36,858	\$ 140,144	\$ 119,076
Legal collections	55,584	49,765	173,451	144,241
Collection agencies	19,705	7,881	42,878	28,851
Sales	5,299	3,166	6,843	11,013
Other		107		1,081
Gross collections for the period	\$ 125,710	\$ 97,777	\$ 363,316	\$ 304,262

Note 5: Deferred Court Costs

The Company contracts with a nationwide network of attorneys that specialize in collection matters. The Company generally refers charged-off accounts to its contracted attorneys when it believes the related debtor has sufficient assets to repay the indebtedness and has, to date, been unwilling to pay. In connection with the Company's agreement with the contracted

Table of Contents

attorneys, it advances certain out-of-pocket court costs (Deferred Court Costs). The Company capitalizes Deferred Court Costs in its consolidated financial statements and provides a reserve for those costs that it believes will ultimately be uncollectible. The Company determines the reserve based on its analysis of court costs that have been advanced and those that have been recovered. Deferred Court Costs not recovered within three years of placement are fully written off. Collections received from these debtors are first applied against related court costs with the balance applied to the debtors' account.

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

	September 30, 2009	December 31, 2008
Court costs advanced	\$ 169,864	\$ 145,579
Court costs recovered	(43,982)	(36,929)
Court costs reserve	(98,172)	(80,315)
	\$ 27,710	\$ 28,335

Note 6: Other Assets

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

	September 30, 2009	December 31, 2008 Adjusted
Debt issuance costs	\$ 842	\$ 1,953
Deferred compensation assets	730	1,206
Prepaid expenses	1,668	973
Security deposit India building lease	985	
Other	189	917
	\$ 4,414	\$ 5,049

Note 7: Debt

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

	September 30, 2009	December 31, 2008 Adjusted
Convertible Senior Notes	\$ 42,920	\$ 71,422
Less: Debt discount	(2,703)	(7,664)
Revolving Credit Facility	282,000	238,000
Capital Lease Obligations	2,177	1,897
	\$ 324,394	\$ 303,655

Convertible Senior Notes

In 2005, the Company issued \$100.0 million of 3.375% Convertible Notes due September 19, 2010. Interest on the Convertible Notes is payable semi-annually, in arrears, on March 19 and September 19 of each year. The Convertible Notes rank equally with the Company's existing and

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future senior indebtedness and are senior to the Company's potential future subordinated indebtedness. Prior to the implementation of the net-share settlement feature discussed below, the Convertible Notes were convertible, prior to maturity, subject to certain conditions described below, into shares of the Company's common stock at an initial conversion rate of 44.7678 per \$1,000 principal amount of notes, which represented an initial conversion price of approximately \$22.34 per share, subject to adjustment.

In October 2005, the Company obtained stockholder approval of a net-share settlement feature that allows the Company to settle conversion of the Convertible Notes through a combination of cash and stock. Based on the provisions of Subtopic 470-20, the net-settlement feature is accounted for as convertible debt and is not subject to the provisions of FASB ASC Subtopic 815-15 *Embedded Derivatives* (prior authoritative literature: Statement of Financial Accounting Standards No. 133 (FAS

Table of Contents

133). *Accounting for Derivative Instruments and Hedging Activities*). As a result of the net-settlement feature, the Company will be able to substantially reduce the number of shares issuable in the event of conversion of the Convertible Notes by repaying principal in cash instead of issuing shares of common stock for that amount. Additionally, the Company will not be required to include the underlying shares of common stock in the calculation of the Company's diluted weighted average shares outstanding for earnings per share until the Company's common stock price exceeds \$22.34.

Effective January 1, 2009, the Company retrospectively adopted the provisions of Subtopic 470-20 to account for its Convertible Notes. Subtopic 470-20 requires that issuers of convertible debt instruments that, upon conversion, may be settled fully or partially in cash, must separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Additionally, debt issuance costs are required to be allocated in proportion to the allocation of the liability and equity components and accounted for as debt issuance costs and equity issuance costs, respectively. This subtopic requires retrospective application and, accordingly, the prior periods' financial statements included herein have been adjusted. See Note 12 for additional information and the effect of the change in accounting principle on the Company's condensed consolidated financial statements.

During the nine months ended September 30, 2009, the Company repurchased \$28.5 million principal amount of its outstanding Convertible Notes for a total price of \$22.3 million plus accrued interest. These repurchases left \$42.9 million principal amount of the Company's Convertible Notes outstanding as of September 30, 2009, and resulted in a net gain of \$3.3 million for the nine months ended September 30, 2009. The Company has written-off approximately \$0.2 million in debt issuance costs and \$2.7 million in debt discount in connection with the repurchase of its Convertible Notes during the nine months ended September 30, 2009. No repurchases were made during the three months ended September 30, 2009.

During the nine months ended September 30, 2008, the Company repurchased \$5.0 million principal amount of its outstanding Convertible Notes for a total price of \$3.5 million plus accrued interest. The repurchase resulted in a net gain of \$0.7 million. The Company wrote-off approximately \$0.1 million in debt issuance costs and \$0.7 million in debt discount in connection with the repurchase of its Convertible Notes during the nine months ended September 30, 2008. No repurchases were made during the three months ended September 30, 2008.

In accordance with the provisions of Subtopic 470-20, the Company determined that the fair value of the Convertible Notes at issuance in 2005 was approximately \$73.2 million, and designated the residual value of approximately \$26.8 million as the equity component. Additionally, the Company allocated approximately \$2.5 million of the \$3.4 million original Convertible Notes issuance cost as debt issuance cost and the remaining \$0.9 million as equity issuance cost.

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

	September 30, 2009	December 31, 2008 Adjusted
Liability component principal amount	\$ 42,920	\$ 71,422
Unamortized debt discount	(2,703)	(7,664)
Liability component net carrying amount	40,217	63,758
Equity component	25,878	25,878

The remaining debt discount is being amortized into interest expense over the remaining life of the Convertible Notes using the effective interest rate. The Convertible Notes are due on September 19, 2010. The effective interest rate on the liability component was 10.38% for the nine months ended September 30, 2009 and 2008.

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

	Three Months Ended September 30, 2009	September 30, 2008 Adjusted	Nine Months Ended September 30, 2009	September 30, 2008 Adjusted
Interest expense stated coupon rate	\$ 362	\$ 802	\$ 1,270	\$ 2,455
Interest expense amortization of debt discount	651	1,302	2,211	3,891

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Total interest expense convertible notes	\$ 1,013	\$ 2,104	\$ 3,481	\$ 6,346
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As of September 30, 2009, the Company is making the required interest payments on the Convertible Notes and no other changes in the balance or structure of the Convertible Notes has occurred.

Table of Contents

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

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

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

the Company enters into specified corporate transactions; or

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

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

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

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

The warrants have a strike price of \$29.04 and are generally exercisable at any time. The Company issued and sold the warrants in a transaction exempt from the registration requirements of the Securities Act of 1933, as amended, because the offer and sale did not involve a public offering. There were no underwriting commissions or discounts in connection with the sale of the warrants. In accordance with FASB ASC Topic 480 *Distinguishing Liabilities from Equity* (prior authoritative literature: Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*), the Company recorded the net call options and warrants as a reduction in additional paid in capital as of December 31, 2005, and will not recognize subsequent changes in fair value of the call options and warrants in its consolidated financial statements.

Revolving Credit Facility

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

Effective February 27, 2007, the Company amended the Revolving Credit Facility to allow for the Company to repurchase up to \$50.0 million of its common stock and Convertible Notes, with no more than \$25.0 million to repurchase Convertible Notes. Effective May 9, 2008, the Company amended the Revolving Credit Facility to remove the \$25.0 million cap on Convertible Note repurchases and allow for the Company to repurchase up to \$50.0 million in any combination of its common stock and Convertible Notes, subject to compliance with certain covenants and available borrowing capacity.

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

Table of Contents

Effective October 19, 2007, the Company amended the Revolving Credit Facility to change the definition of change of control to exclude from that definition, acquisitions of stock by Red Mountain Capital Partners LLC (Red Mountain), JCF FPK I LP (JCF FPK) and their respective affiliates.

Effective July 3, 2008, the Company amended the Revolving Credit Facility to expand the capacity from \$230.0 million to \$335.0 million. This amendment added three additional lenders to the syndicate of lenders in the Revolving Credit Facility and increased the applicable margin under certain circumstances between 25 and 75 basis points.

Other provisions of the amended Revolving Credit Facility include:

Interest at a floating rate equal to, at the Company's option, either: (a) reserve adjusted LIBOR plus a spread that ranges from 225 to 275 basis points, depending on the Company's leverage; or (b) the higher of the federal funds rate then in effect plus a spread of 50 basis points or the prime rate plus a spread that ranges from 25 to 75 basis points.

\$5.0 million sub-limits for swingline loans and letters of credit.

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

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

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

Collateralization by all assets of the Company.

At September 30, 2009, the outstanding balance on the Revolving Credit Facility was \$282.0 million, which bore a weighted average interest rate of 3.74% and 3.86% for the three and nine months ended September 30, 2009, respectively. The aggregate borrowing base as of September 30, 2009, was \$324.2 million, of which \$42.2 million was available for future borrowings.

Derivative Instruments

The Company entered into two separate interest rate swap agreements intended to manage interest rates more effectively by establishing a set level of fixed rates associated with a portion of the borrowings under its Revolving Credit Facility. Under the swap agreements, the Company receives floating interest rate payments and makes interest payments based on fixed interest rates. The first agreement is for a notional amount of \$25.0 million, a term of three years and a fixed interest rate of 4.99%. The second agreement is for a notional amount of \$25.0 million, a term of four years and a fixed interest rate of 5.01%. No credit spread was hedged. The Company intends to continue electing the one-month reserve-adjusted LIBOR as the benchmark interest rate on the debt being hedged through its term. The Company does not intend to repay the Revolving Credit Facility below the notional amounts of the interest rate swaps before the maturity of these swaps. In accordance with the provisions of FASB ASC Subtopic 815-30 *Cash Flow Hedges* (prior authoritative literature: FAS 133), the Company designates its interest rate swap instruments as cash flow hedges.

FASB ASC Topic 815 (Topic 815) *Derivatives and Hedging* (prior authoritative literature: FAS 133) requires companies to recognize derivative instruments as either an asset or liability measured at fair value in the statement of financial position. The effective portion of the change in fair

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value of the derivative instrument is recorded in other comprehensive income. The ineffective portion of the change in fair value of the derivative instrument, if any, is recognized in interest expense in the period of change. From the inception of the hedging program, the Company has determined that the hedging instruments are highly effective.

Table of Contents

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

	Liability Derivatives			
	As of September 30, 2009		As of December 31, 2008	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments under Topic 815				
Interest rate swaps	Other liabilities	\$ 2,306	Other liabilities	\$ 3,483

The following tables summarize the effect of the interest rate swaps for the three and nine months ended September 30, 2009 and 2008 on the Company's statements of income (*in thousands*):

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) Three Months Ended		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Three Months Ended		Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) and Amount Excluded from Effectiveness Testing)	
	September 30, 2009	2008		September 30, 2009	2008		September 30, 2009	2008
Interest rate swaps	\$ 342	\$ 18	Interest expense	\$	\$	Other income (expense)	\$	\$

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) Three Months Ended		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Three Months Ended		Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) and Amount Excluded from Effectiveness Testing)	
	September 30, 2009	2008		September 30, 2009	2008		September 30, 2009	2008
Interest rate swaps	\$ 1,177	\$ (8)	Interest expense	\$	\$	Other income (expense)	\$	\$

Capital Lease Obligations

The Company has capital lease obligations for certain computer equipment. These lease obligations require monthly payments that range from approximately \$1,000 to \$20,000 through June 2013 and have implicit interest rates that range from approximately 5.9% to 7.7%.

The Company finances certain leasehold improvement projects with its lessors in its Phoenix and St. Cloud facilities. As of September 30, 2009, the Company's combined obligation was approximately \$1.1 million. These financing agreements require monthly principal and interest payments, accrue interest at 8% to 9% per annum and will mature in June and September 2013.

Note 8: Income Taxes

The Company recorded an income tax provision of \$5.9 million, reflecting an effective rate of 39.8% of pretax income during the three months ended September 30, 2009. The effective tax rate for the three months ended September 30, 2009, consists primarily of a provision for federal income taxes of 32.3% (which is net of a benefit for state taxes of 2.7%), a provision for state taxes of 7.8%, the benefit of permanent book versus tax differences and a state refund of 0.3%. Effective January 1, 2009, the Company retrospectively adjusted its prior years' income tax provisions for the change in accounting principle related to its accounting for Convertible Notes. See Note 12 for additional information on the change in accounting principle. The adjusted income tax provision for the three months ended September 30, 2008, was \$2.4 million, reflecting an effective rate of 44.3% of pretax income. The effective tax rate for the three months ended September 30, 2008, 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 a provision for the effect of permanent book versus tax differences of 3.6%.

The Company recorded an income tax provision of \$16.1 million, reflecting an effective rate of 39.5% of pretax income during the nine months ended September 30, 2009. The effective tax rate for the nine months ended September 30, 2009, consists primarily of a provision for federal income taxes of 32.3% (which is net of a benefit for state taxes of 2.7%), a

Table of Contents

provision for state taxes of 7.8%, the benefit of permanent book versus tax differences and a state refund of 0.6%. Effective January 1, 2009, the Company retrospectively adjusted its prior years' income tax provisions for the change in accounting principle related to its accounting for Convertible Notes. See Note 12 for additional information on the change in accounting principle. The adjusted income tax provision for the nine months ended September 30, 2008, was \$11.1 million, reflecting an effective rate of 41.1% of pretax income. The effective tax rate for the nine months ended September 30, 2008, 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 a provision for the effect of permanent book versus tax differences of 0.4%.

Effective January 1, 2007, the Company adopted the provisions related to uncertainty in income taxes within ASC Topic 740 (Topic 740) *Income Taxes* (prior authoritative literature: FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*). As of September 30, 2009, the Company had a gross unrecognized tax benefit of \$1.2 million that, if recognized, would result in a net tax benefit of approximately \$0.9 million and would have a positive effect on the Company's effective tax rate. During the three and nine months ended September 30, 2009, there were no material changes to the unrecognized tax benefit.

For the three and nine months ended September 30, 2009, the Company has not provided for the United States income taxes or foreign withholding taxes on the quarterly undistributed earnings from continuing operations of its subsidiary operating outside of the United States. Undistributed earnings of the subsidiary for the three and nine months ended September 30, 2009, were approximately \$0.2 million and \$0.6 million, respectively. Such undistributed earnings are considered permanently reinvested.

The Company's subsidiary operating outside of the United States is currently operating under a tax holiday in India. The tax holiday is due to expire on March 31, 2011. The impact of the tax holiday on the Company's condensed consolidated financial statements is not material.

Note 9: Purchase Concentrations

The following table summarizes the concentration of our purchases by seller sorted by total aggregate costs (*in thousands, except percentages*):

	Concentration of Initial Purchase	
	Cost by Seller for the Nine Months Ended September 30, 2009	
	Cost	%
Seller 1	\$ 53,995	25.0%
Seller 2	43,014	19.9%
Seller 3	42,386	19.7%
Seller 4	27,000	12.5%
Seller 5	22,670	10.5%
Other	26,615	12.4%
	\$ 215,680	100.0%
Adjustments ⁽¹⁾	(666)	
Purchases, net	\$ 215,014	

⁽¹⁾ Adjusted for Put-backs and Recalls.

Note 10: Commitments and Contingencies**Litigation**

On October 18, 2004, Timothy W. Moser, one of the Company's former officers, filed an action in the United States District Court for the Southern District of California against the Company, and certain individuals, including several of the Company's officers and directors. On February 14, 2005, the Company was served with an amended complaint in this action alleging defamation, intentional interference with contractual relations, breach of contract, breach of the covenant of good faith and fair dealing, intentional and negligent infliction of emotional distress and civil conspiracy arising out of certain statements in the Company's Registration Statement on Form S-1, originally filed in September

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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,

Table of Contents

2006, the court denied the Company's special motion to strike pursuant to California's anti-SLAPP statute, denied in part and granted in part the Company's motion to dismiss, denied a variety of *ex parte* motions and applications filed by the plaintiff and denied the plaintiff's motion for leave to conduct discovery or file supplemental briefing. The court granted the plaintiff 30 days in which to further amend his complaint, and on June 1, 2006, the plaintiff filed a second amended complaint in which he amended his claim for negligent infliction of emotional distress. On May 25, 2006, the Company filed a notice of appeal of the court's order denying the anti-SLAPP motion and on June 16, 2006, the Company filed a motion to stay the case pending the outcome of the appeal, which was granted. Oral argument on the appeal was heard on July 17, 2008, and on July 28, 2008, the appellate court affirmed the trial court's denial of the Company's anti-SLAPP motion. The appellate court denied the Company's request for a rehearing and the case has been returned to the district court where it is proceeding from the point at which it was stayed. Discovery is in the final stages and the parties have filed various motions. Management believes the claims are without merit and intends to defend the action vigorously.

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.

The Company, along with others in its industry, are subject to legal actions based on the Fair Debt Collection Practices Act, or FDCPA, and comparable state statutes, which could have a material adverse effect on the Company due to the remedies available under these statutes, including punitive damages. The claimed violations of law include allegations that the Company lacks specified licenses to conduct its business, attempts to collect debts on which the statute of limitations has run, and has made inaccurate assertions of fact in support of its collection actions. A number of these cases are styled as class actions and a class has been certified in several of these cases. Many 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. However, court rulings in these or other legal actions could affect the Company's debt collection procedures in the future.

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 damages arising from a variety of alleged misconduct or improper reporting of credit information by the Company or its employees or agents.

In addition, from time to time, the Company is subject to various regulatory investigations relating to its collection activities. For example, on September 21, 2009, the Maryland Department of Labor, Licensing and Regulation, or MDLLR, issued a cease and desist order, barring all collection activities by the Company and certain of its affiliates, alleging that the Company had failed to obtain necessary business licenses and had improperly filed lawsuits to collect credit card accounts, among other claims raised in certain of the legal actions pending against the Company. Pursuant to an Interim Settlement Agreement the Company executed with MDLLR on September 23, 2009, certain of the Company's affiliates will refrain from collection activities in Maryland until obtaining licenses. Additionally, the Company agreed to assemble certain information and provide it to MDLLR in furtherance of their investigation. While the Company has assembled and supplied the information requested by MDLLR and has applied for the specified licenses, the pending collection lawsuits filed by the Company in Maryland remain subject to a stay pending the outcome of the investigation or other administrative action. Nevertheless, under the Interim Settlement Agreement, the Company's licensed affiliate was permitted to resume other collection agency business activities within the state of Maryland. The Company cannot predict when or if it will be granted the specified licenses or be able to fully resume collection activities in Maryland, or whether it will be subject to fines or other penalties as a result of this on-going investigation.

In connection with the Company's acquisition of certain assets of Jefferson Capital in June 2005, the Company entered into a forward flow agreement to purchase a minimum of \$3.0 billion in face value of credit card charge-offs over a five-year period at a fixed price. In June 2008, the Federal Trade Commission (the FTC) announced that it had sued Jefferson Capital and its parent company, CompuCredit Corporation, alleging that Jefferson Capital and CompuCredit had violated the FTC Act with deceptive marketing practices when issuing credit cards. The FTC announced in December 2008, that it had agreed to a settlement of the litigation with Jefferson Capital and CompuCredit, whereby those companies will credit approximately \$114.0 million to certain customer accounts. Jefferson Capital and CompuCredit advised the Company that a substantial number of the accounts affected by the settlement had been sold to the Company.

Table of Contents

In July 2008, the Company initiated an arbitration proceeding against Jefferson Capital and CompuCredit based upon the allegations noted in the FTC complaint and other claims. Jefferson Capital and CompuCredit raised their own claims against the Company in the arbitration. In September 2009, the Company settled the dispute with Jefferson Capital and CompuCredit. Under the terms of the settlement, the Company purchased a large portfolio of charged-off credit card account balances on commercially reasonable terms and agreed to resume balance transfers to Jefferson Capital. The forward flow asset of \$10.3 million was fully allocated to the purchase price of this portfolio. The Company also agreed to return to Jefferson Capital certain accounts that were subject to Jefferson Capital's settlement with the FTC. Following its settlement with Jefferson Capital and CompuCredit, the Company will have no further forward flow purchase obligations with Jefferson Capital and CompuCredit.

The Company has established loss provisions only for matters in which losses are probable and can be reasonably estimated. Some of the matters pending against the Company involve potential compensatory, punitive damage claims, fines or sanctions that, if granted, could require the Company to pay damages or make other expenditures in amounts that could have a material adverse effect on the Company's financial position or results of operations. Although litigation is inherently uncertain, at this time, based on past experience, the information currently available and the possible availability of insurance and/or indemnification in some cases, management does not believe that the resolution of these matters will have a material adverse effect on the Company's consolidated financial position or results of operations.

Purchase Commitments

In the normal course of business, the Company enters into forward flow purchase agreements and other purchase commitment agreements. As of September 30, 2009, the Company has entered into agreements to purchase receivable portfolios with a face value of approximately \$1.2 billion for a purchase price of approximately \$53.3 million. Certain of these agreements allow the Company to terminate the commitment with 60 days notice or by paying a one-time cancellation fee. The Company does not anticipate cancelling any of these commitments at this time. The Company has no purchase commitments extending past one year.

Note 11: Securities Repurchase Program

On February 27, 2007, the Company's board of directors authorized a securities repurchase program under which the Company may buy back up to \$50.0 million (at cost) of a combination of its common stock and Convertible Notes. The purchases may be made from time to time in the open market or through privately negotiated transactions and will be dependent upon various business and financial considerations. Repurchases are subject to compliance with applicable legal requirements and other factors. During the nine months ended September 30, 2009, the Company repurchased \$28.5 million principal amount of its outstanding Convertible Notes, for a total price of \$22.3 million, plus accrued interest. From the inception of the securities repurchase program, the Company has repurchased \$57.1 million principal amount of its Convertible Notes, for a total cash payment of \$42.4 million. The Company has not repurchased any common stock under this program.

Note 12: Change in Accounting Principle

Effective January 1, 2009, the Company adopted the provisions of ASC Subtopic 470-20 (Subtopic 470-20) *Debt with Conversion and Other Options* (prior authoritative literature: FASB Staff Position APB 14-1 *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*). Subtopic 470-20 applies to convertible debt instruments that may be settled in cash upon conversion, including partial cash settlement, when the conversion option does not need to be bifurcated and accounted for separately as a derivative instrument in accordance with Topic 815.

Subtopic 470-20 requires that issuers of convertible debt instruments that, upon conversion, may be settled fully or partially in cash, must separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Additionally, debt issuance costs are required to be allocated in proportion to the allocation of the liability and equity components and accounted for as debt issuance costs and equity issuance costs, respectively. Subtopic 470-20 requires retrospective application and, accordingly, the prior periods' financial statements included herein have been adjusted.

Table of Contents**Effect of Change in Accounting Principle to Consolidated Financial Statements**

The 2008 condensed consolidated financial statements presented in this quarterly report have been retroactively adjusted to reflect the change in accounting principle related to the Company's Convertible Notes. The following table provides the impact of Subtopic 470-20 on the 2008 condensed consolidated financial statements (*in thousands, except per share amounts*):

	As Previously Reported	As Adjusted by Subtopic 470-20	Effect of Change
Condensed Consolidated Statements of Financial Condition			
<i>(As of December 31, 2008)</i>			
Assets:			
Other assets ⁽¹⁾	\$ 5,268	\$ 5,049	\$ (219)
Total assets	549,298	549,079	(219)
Liabilities:			
Deferred tax liabilities, net	\$ 15,199	\$ 15,108	\$ (91)
Debt	311,319	303,655	(7,664)
Total liabilities	353,408	345,653	(7,755)
Stockholders' equity:			
Additional paid-in capital	\$ 79,971	\$ 98,521	\$ 18,550
Accumulated earnings	117,809	106,795	(11,014)
Total stockholders' equity	195,890	203,426	7,536
Total liabilities and stockholders' equity	549,298	549,079	(219)
Condensed Consolidated Statements of Income			
<i>(Three months ended September 30, 2008)</i>			
Interest expense	\$ (3,880)	\$ (5,140)	\$ (1,260)
Income before income taxes	6,696	5,436	(1,260)
Provision for income taxes	(2,923)	(2,408)	515
Net Income	3,773	3,028	(745)
Earnings Per Share:			
Basic	\$ 0.16	\$ 0.13	\$ (0.03)
Diluted	0.16	0.13	(0.03)
<i>(Nine months ended September 30, 2008)</i>			
Interest expense	\$ (11,409)	\$ (15,171)	\$ (3,762)
Gain on repurchase of convertible notes, net	1,417	707	(710)
Income before income taxes	31,555	27,083	(4,472)
Provision for income taxes	(12,952)	(11,142)	1,810
Net Income	18,603	15,941	(2,662)
Earnings Per Share:			
Basic	\$ 0.81	\$ 0.69	\$ (0.12)
Diluted	0.79	0.68	(0.11)
Condensed Consolidated Statements of Cash Flows			
<i>(Nine months ended September 30, 2008)</i>			
Net Income	\$ 18,603	\$ 15,941	\$ (2,662)
Amortization of loan costs and debt discount	989	4,751	3,762
Deferred income tax expense	762	825	63
Change in prepaid income tax ⁽¹⁾	11,793	9,920	(1,873)
Gain on repurchase of convertible notes, net	(1,417)	(707)	710
Net cash provided by operating activities ⁽¹⁾	45,284	45,284	

⁽¹⁾ Certain reclassifications other than the impact of Subtopic 470-20 have been made to conform to the current year's presentation.

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, 2008 contained in our 2008 Annual Report on Form 10-K. The Form 10-K contains a general description of our industry and a discussion of recent trends affecting the industry. Certain statements herein may constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995 (the Reform Act), for which we claim the protection of the safe harbor of the Reform Act. See Part II, Item 1A Risk Factors for more discussion on our forward-looking statements.

Introduction

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

Market Overview

The United States and global economies are currently in a recession. In the U.S., the availability of credit is limited, unemployment rates are at 25-year highs, while credit card charge-offs and delinquencies have reached a 20-year high increasing approximately 30% from third quarter 2008 levels. At the same time, home foreclosures have dramatically increased and the housing market is experiencing a significant downturn. These conditions present both opportunities and challenges for Encore.

On the opportunities side, the increase in credit card charge-offs and delinquencies (which contribute to an increase in supply), combined with the challenges some of our competitors are facing in (i) generating sufficient returns on receivables they purchased in 2005 - 2007, when prices were high and (ii) obtaining sufficient capital to fund future purchases (which contributes to a decrease in demand) have resulted in a significant reduction in the market price for portfolios of charged-off receivables. For example, prices for fresh charge-offs (receivables that are sold immediately after charge-off) have declined from 8% - 13% of face value in 2008 to 4% - 8% of face value in 2009. We have seen similar pricing declines across all ages of charge-offs and the decline is more pronounced in the resale market. While this is generally positive for our business, as a result of the significant price decline, some sellers of portfolios have chosen not to sell and, as an alternative to selling their charge-offs, have collected on accounts internally or placed accounts with third-party collection agencies. As such, the full impact the price reduction will have on our purchasing volumes is presently unclear.

On the challenges side, increases in unemployment, high foreclosure rates and the difficulties consumers are experiencing in obtaining credit may, for a period of time, negatively impact collections on receivables that we currently own or that we purchase during these challenging economic times. Despite these market conditions, during 2009, most of the collection metrics we track have remained relatively consistent, as compared to 2008. For example, payer rates and average payment size, adjusted for the change in single payment/payment plan mix, have remained relatively constant. One change we have noted is that more consumers are settling their debts through payment plans rather than in one-time settlements. While settlement rates remain consistent, payments made over longer periods of time impact our business in two ways. First, when payments are extended over longer periods of time rather than received up front, this delay in cash flows could result in a provision for impairment. This is because discounting a long-term payment stream using our pool group IRRs rather than discounting a one-time settlement payment using the same IRR will result in a lower net present value. As a result, even if the cash received through long-term payment plans is the same as the cash received through one-time settlements, accounting for the stream of payments may result in a provision for impairment. Second, when debts are settled through payment plans, there is a possibility that consumers will not make all of the payments required by those plans. We refer to consumers who do not make all of their payments as broken payers. When this happens, we are often successful in getting the consumer back on plan, but this is not always the case and, in those instances where we are unable to get the consumer back on plan, we experience a shortfall in collections. Despite the current economic environment, we have not experienced an increase in the broken payer rate in 2009 as compared to the same period in 2008. Please refer to Management's Discussion and Analysis Revenue below for a more detailed explanation of the provision for impairment for the three and nine months ended September 30, 2009.

Table of Contents

As a result of the uncertainties presented by the current economic environment, we believe we are applying conservative assumptions when valuing portfolios for purchase and when establishing our forecasted collections. Additionally, while we believe that consumers who are currently charging off their debt (when economic conditions are bad) are more likely to recover faster than consumers who charged off their debt historically (when economic times were good), we have not factored any such recovery into our forecasts.

When evaluating the overall long-term returns of our business, we believe that the benefits resulting from the current lower portfolio pricing will outweigh the negative impacts from the collection shortfalls we may experience from a more distressed consumer. However, if the lower pricing environment re-attracts significant capital to our industry and prices are bid up, or if the ability of the consumer to repay their debt deteriorates further, our returns would be negatively impacted.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Credit card	\$ 77,734	\$ 57,107	\$ 215,680	\$ 142,552
Other		9,000		23,949
	\$ 77,734	\$ 66,107	\$ 215,680	\$ 166,501

During the three months ended September 30, 2009, we invested \$77.7 million for portfolios with face values aggregating \$2.2 billion for an average purchase price of 3.6% of face value. This is an \$11.6 million increase, or 17.6%, in the amount invested, compared with the \$66.1 million invested during the three months ended September 30, 2008, to acquire portfolios with a face value aggregating \$1.8 billion for an average purchase price of 3.6% of face value. During the nine months ended September 30, 2009, we invested \$215.7 million for portfolios with face values aggregating \$5.5 billion for an average purchase price of 4.0% of face value. This is a \$49.2 million increase, or 29.5%, in the amount invested compared with the \$166.5 million invested during the nine months ended September 30, 2008, to acquire portfolios with a face value aggregating \$4.8 billion for an average purchase price of 3.4% of face value. Average purchase price, as a percentage of face value, varies from period to period depending on, among other things, the quality of the accounts purchased and the length of time from charge off to the time we purchase the portfolios.

Collections by Channel

During the three and nine months ended September 30, 2009 and 2008, we utilized several business channels for the collection of charged-off credit card receivables and other charged-off receivables. The following table summarizes gross collections by collection channel (*in thousands*):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Collection sites	\$ 45,122	\$ 36,858	\$ 140,144	\$ 119,076
Legal collections	55,584	49,765	173,451	144,241
Collection agencies	19,705	7,881	42,878	28,851
Sales	5,299	3,166	6,843	11,013
Other		107		1,081
Gross collections for the period	\$ 125,710	\$ 97,777	\$ 363,316	\$ 304,262

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Gross collections increased \$27.9 million, or 28.6%, to \$125.7 million during the three months ended September 30, 2009, from \$97.8 million during the three months ended September 30, 2008.

Gross collections increased \$59.0 million, or 19.4%, to \$363.3 million during the nine months ended September 30, 2009, from \$304.3 million during the nine months ended September 30, 2008.

Table of Contents**Results of Operations**

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

	Three Months Ended September 30,			
	2009		2008 Adjusted ⁽¹⁾	
Revenue				
Revenue from receivable portfolios, net	\$ 76,448	95.1%	\$ 62,557	94.3%
Servicing fees and other related revenue	3,938	4.9%	3,816	5.7%
Total revenue	80,386	100.0%	66,373	100.0%
Operating expenses				
Salaries and employee benefits	14,411	17.9%	14,963	22.5%
Stock-based compensation expense	1,261	1.6%	860	1.3%
Cost of legal collections	26,092	32.5%	25,390	38.3%
Other operating expenses	6,034	7.5%	6,018	9.1%
Collection agency commissions	5,795	7.2%	2,996	4.5%
General and administrative expenses	7,280	9.1%	4,864	7.3%
Depreciation and amortization	652	0.8%	674	1.0%
Total operating expenses	61,525	76.6%	55,765	84.0%
Income before other (expense) income and income taxes	18,861	23.4%	10,608	16.0%
Other (expense) income				
Interest expense	(3,970)	(4.9)%	(5,140)	(7.8)%
Gain on repurchase of convertible notes		0.0%		0.0%
Other income (expense)	61	0.1%	(32)	0.0%
Total other expense	(3,909)	(4.8)%	(5,172)	(7.8)%
Income before income taxes	14,952	18.6%	5,436	8.2%
Provision for income taxes	(5,948)	(7.4)%	(2,408)	(3.6)%
Net income	\$ 9,004	11.2%	\$ 3,028	4.6%

	Nine Months Ended September 30,			
	2009		2008 Adjusted ⁽¹⁾	
Revenue				
Revenue from receivable portfolios, net	\$ 222,688	94.8%	\$ 192,900	94.6%
Servicing fees and other related revenue	12,179	5.2%	11,047	5.4%
Total revenue	234,867	100.0%	203,947	100.0%
Operating expenses				
Salaries and employee benefits	43,130	18.4%	45,503	22.3%
Stock-based compensation expense	3,335	1.4%	3,182	1.6%
Cost of legal collections	84,665	36.1%	69,525	34.1%
Other operating expenses	18,612	7.9%	17,656	8.7%

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Collection agency commissions	13,483	5.7%	10,808	5.3%
General and administrative expenses	20,074	8.6%	13,905	6.8%
Depreciation and amortization	1,895	0.8%	2,162	1.0%
Total operating expenses	185,194	78.9%	162,741	79.8%
Income before other (expense) income and income taxes	49,673	21.1%	41,206	20.2%
Other (expense) income				
Interest expense	(12,201)	(5.2)%	(15,171)	(7.4)%
Gain on repurchase of convertible notes	3,268	1.4%	707	0.3%

Table of Contents

	Nine Months Ended September 30,			
	2009		2008	
			Adjusted ⁽¹⁾	
Other (expense) income	(11)	(0.0)%	341	0.2%
Total other expense	(8,944)	(3.8)%	(14,123)	(6.9)%
Income before income taxes	40,729	17.3%	27,083	13.3%
Provision for income taxes	(16,087)	(6.8)%	(11,142)	(5.5)%
Net income	\$ 24,642	10.5%	\$ 15,941	7.8%

(1) Adjusted for change in accounting principle related to our convertible senior notes. See Note 12 to our unaudited condensed consolidated financial statements for additional information and the effect of the change in accounting principle to our financial statements.

Comparison of Results of Operations**Revenue**

Our revenue consists primarily of portfolio revenue and bankruptcy servicing revenue. Portfolio revenue consists of accretion revenue and zero basis revenue. Accretion revenue represents revenue derived from pools (quarterly groupings of purchased receivable portfolios) with a cost basis that has not been fully amortized. Revenue from pools with a remaining unamortized cost basis is accrued based on each pool's effective interest rate applied to each pool's remaining unamortized cost basis. The cost basis of each pool is increased by revenue earned and decreased by gross collections and impairments. The effective interest rate is the internal rate of return derived from the timing and amounts of actual cash received and anticipated future cash flow projections for each pool. All collections realized after the net book value of a portfolio has been fully recovered (Zero Basis Portfolios) are recorded as revenue (Zero Basis Revenue). We account for our investment in receivable portfolios utilizing the interest method in accordance with the provisions of Financial Accounting Standard Board (FASB) Accounting Standards Codification (ASC) Subtopic 310-30 (Subtopic 310-30) *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (prior authoritative literature: AICPA's Statement of Position 03-3, *Accounting for Certain Debt Securities Acquired in a Transfer*). Servicing fee revenue is revenue primarily associated with bankruptcy servicing fees earned from our subsidiary, Ascension Capital Group, Inc. (Ascension), a provider of bankruptcy services to the finance industry.

Effective January 1, 2008, we revised our Unified Collection Score (UCS) and Behavioral Liquidation Score (BLS) methodologies by extending our collection forecast from 72 months to 84 months. UCS is a proprietary forecasting tool that generates portfolio level expectations of liquidation for portfolios that we have owned and serviced for more than six months. BLS forecasts portfolio level expectations based on credit characteristics for portfolios owned and serviced less than six months. We have observed that receivable portfolios purchased in 2001 and prior have consistently experienced cash collections beyond 72 months from the date of purchase. When we first developed our cash forecasting models in 2001, limited historical collection data was available with which to accurately model projected cash flows beyond 60 months. During the quarter ended June 30, 2006, we determined there was enough additional collection data accumulated over the previous several years, in addition to improvements in our forecasting tools, allowing us to extend the collection forecast to 72 months. During the quarter ended March 31, 2008, we determined that there was enough additional collection data to accurately extend the collection forecast in both our UCS and BLS models to 84 months. The increase in the collection forecast from 72 to 84 months was applied, effective January 1, 2008, to each portfolio for which we could accurately forecast through such term and resulted in an increase in the aggregate total estimated remaining collections for the receivable portfolios by \$67.3 million, or 7.5%, as of March 31, 2008. We did not extend the forecast on telecom portfolios as we do not anticipate significant collections past 72 months on these portfolios. The extension of the collection forecast is treated as a change in estimate and, in accordance with the provisions of FASB ASC Topic 250 *Accounting Changes and Error Corrections* (prior authoritative literature Statement of Financial Accounting Standard No. 154, *Accounting Changes and Error Corrections*) is being recognized prospectively in our consolidated financial statements. This prospective treatment resulted in a reduction in our net impairment provision of \$3.1 million and an increase in revenue of \$0.1 million for the quarter ended March 31, 2008. The impact of the change in estimate resulted in an increase in net income of \$1.9 million and an increase in fully diluted earnings per share of \$0.08 for the quarter ended March 31, 2008.

Table of Contents

The following tables summarize collections, revenue, end of period receivable balance and other related supplemental data by year of purchase (in thousands, except percentages):

	For the Three Months Ended September 30, 2009				As of September 30, 2009		
	Collections ⁽¹⁾	Gross Revenue ⁽²⁾	Revenue Recognition Rate ⁽³⁾	Net (Impairment) Reversal	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR ⁽⁴⁾
ZBA	\$ 2,100	\$ 2,100	100.0%	\$	2.6%	\$	
2002	630	31	4.9%	511	0.0%		0.0%
2003	1,770	1,240	70.1%	(86)	1.5%	967	31.2%
2004	2,648	1,571	59.3%	(147)	1.9%	5,688	8.2%
2005	10,729	6,223	58.0%	(403)	7.7%	33,805	5.6%
2006	12,274	7,698	62.7%	(59)	9.5%	46,932	5.1%
2007	25,659	14,727	57.4%	(2,247)	18.3%	79,562	5.6%
2008	38,715	26,861	69.4%	(1,901)	33.3%	170,640	5.0%
2009	31,111	20,329	65.3%		25.2%	197,062	4.3%
Total	\$ 125,636	\$ 80,780	64.3%	\$ (4,332)	100.0%	\$ 534,656	5.0%

	For the Three Months Ended September 30, 2008				As of September 30, 2008		
	Collections ⁽¹⁾	Gross Revenue ⁽²⁾	Revenue Recognition Rate ⁽³⁾	Net (Impairment) Reversal	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR ⁽⁴⁾
ZBA	\$ 2,259	\$ 2,259	100.0%	\$	3.2%	\$	
2002	1,276	872	68.3%	220	1.2%	895	29.1%
2003	3,327	2,730	82.1%	440	3.9%	2,808	30.7%
2004	4,310	3,584	83.2%	(1,426)	5.1%	14,420	7.9%
2005	15,048	10,805	71.8%	(4,235)	15.5%	61,044	5.6%
2006	16,268	11,418	70.2%	(1,932)	16.4%	72,214	5.1%
2007	36,020	22,798	63.3%	(335)	32.7%	138,876	5.2%
2008	19,189	15,359	80.0%		22.0%	154,706	4.8%
Total	\$ 97,697	\$ 69,825	71.5%	\$ (7,268)	100.0%	\$ 444,963	5.4%

	For the Nine Months Ended September 30, 2009				As of September 30, 2009		
	Collections ⁽¹⁾	Gross Revenue ⁽²⁾	Revenue Recognition Rate ⁽³⁾	Net (Impairment) Reversal	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR ⁽⁴⁾
ZBA	\$ 6,957	\$ 6,957	100.0%	\$	2.9%	\$	
2002	2,341	903	38.6%	764	0.4%		0.0%
2003	6,366	5,169	81.2%	(495)	2.2%	967	31.2%
2004	8,964	5,626	62.8%	(644)	2.4%	5,688	8.2%
2005	33,892	20,901	61.7%	(1,816)	8.8%	33,805	5.6%
2006	36,406	24,949	68.5%	(2,953)	10.5%	46,932	5.1%
2007	89,090	50,704	56.9%	(4,228)	21.4%	79,562	5.6%
2008	127,048	87,789	69.1%	(4,951)	37.0%	170,640	5.0%
2009	51,966	34,013	65.5%		14.4%	197,062	4.3%

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Total	\$ 363,030	\$ 237,011	65.3%	\$ (14,323)	100.0%	\$ 534,656	5.0%
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Table of Contents

	For the Nine Months Ended September 30, 2008				As of September 30, 2008		
	Collections ⁽¹⁾	Gross Revenue ⁽²⁾	Revenue Recognition Rate ⁽³⁾	Net (Impairment) Reversal	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR ⁽⁴⁾
ZBA	\$ 7,440	\$ 7,440	100.0%	\$	3.6%	\$	
2002	4,544	3,331	73.3%	291	1.6%	895	29.1%
2003	11,396	9,681	85.0%	127	4.6%	2,808	30.7%
2004	15,663	12,376	79.0%	(3,003)	5.9%	14,420	7.9%
2005	54,560	37,164	68.1%	(8,880)	17.8%	61,044	5.6%
2006	57,340	37,966	66.2%	(4,086)	18.2%	72,214	5.1%
2007	113,111	72,392	64.0%	(442)	34.6%	138,876	5.2%
2008	39,983	28,543	71.4%		13.7%	154,706	4.8%
Total	\$ 304,037	\$ 208,893	68.7%	\$ (15,993)	100.0%	\$ 444,963	5.4%

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

(2) Gross revenue excludes the effects of net impairment or net impairment reversals.

(3) Revenue recognition rate excludes the effects of net impairment or net impairment reversals.

(4) Our monthly IRR is calculated based on the weighted average of each pool's IRR relative to each pool's percentage of the unamortized balance for each year of purchase. Therefore, it is possible for the monthly IRR to be lower than that reported in the prior quarter due to this weighted average calculation.

Total revenue was \$80.4 million for the three months ended September 30, 2009, an increase of \$14.0 million, or 21.1%, compared to total revenue of \$66.4 million for the three months ended September 30, 2008. Portfolio revenue was \$76.4 million for the three months ended September 30, 2009, an increase of \$13.8 million, or 22.2%, compared to portfolio revenue of \$62.6 million for the three months ended September 30, 2008.

Total revenue was \$234.9 million for the nine months ended September 30, 2009, an increase of \$31.0 million, or 15.2%, compared to total revenue of \$203.9 million for the nine months ended September 30, 2008. Portfolio revenue was \$222.7 million for the nine months ended September 30, 2009, an increase of \$29.8 million, or 15.4%, compared to portfolio revenue of \$192.9 million for the nine months ended September 30, 2008.

The increase in portfolio revenue for the three and nine months ended September 30, 2009, was primarily the result of additional accretion revenue associated with a higher portfolio balance during the three and nine months ending September 30, 2009, compared to the three and nine months ending September 30, 2008, respectively. During the three months ended September 30, 2009, we recorded a net impairment provision of \$4.3 million, compared to a net impairment provision of \$7.3 million during the same period in the prior year. During the nine months ended September 30, 2009, we recorded a net impairment provision of \$14.3 million, compared to a net impairment provision of \$16.0 million during the same period in the prior year. The impairments for the three and nine months ended September 30, 2009 and 2008 were primarily due to a shortfall in collections in certain pool groups against our forecast. While our total collections during the three and nine months ended September 30, 2009 have met or exceeded our forecast, there is often variability at the pool group level between our actual collections and our forecasts. This is the result of several factors, including changes in internal operating strategy, shifts in consumer payment patterns and the inherent challenge of forecasting collections at the pool group level.

Revenue associated with bankruptcy servicing fees earned from Ascension was \$3.9 million for the three months ended September 30, 2009, an increase of \$0.1 million, or 3.2%, compared to revenue of \$3.8 million for the three months ended September 30, 2008. Revenue associated with bankruptcy servicing fees earned from Ascension was \$12.1 million for the nine months ended September 30, 2009, an increase of \$1.1 million, or 10.5%, compared to revenue of \$11.0 million for the nine months ended September 30, 2008. The increase in Ascension revenue for the three and nine months ended September 30, 2009, was due to a slightly higher volume of bankruptcy placements.

Operating Expenses

Total operating expenses were \$61.5 million for the three months ended September 30, 2009, an increase of \$5.7 million, or 10.3%, compared to total operating expenses of \$55.8 million for the three months ended September 30, 2008.

Total operating expenses were \$185.2 million for the nine months ended September 30, 2009, an increase of \$22.5 million, or 13.8%, compared to total operating expenses of \$162.7 million for the nine months ended September 30, 2008.

Table of Contents

Operating expenses are explained in more detail as follows:

Salaries and Employee Benefits

Total salaries and employee benefits decreased by \$0.6 million, or 3.7%, to \$14.4 million during the three months ended September 30, 2009, from \$15.0 million during the three months ended September 30, 2008. The decrease was primarily the result of a decrease of \$0.5 million in compensation related expense, primarily due to a shift in our collection workforce from the United States to India and a change in our compensation plan structure.

Total salaries and employee benefits decreased by \$2.4 million, or 5.2%, to \$43.1 million during the nine months ended September 30, 2009, from \$45.5 million during the nine months ended September 30, 2008. The decrease was primarily the result of a decrease of \$2.5 million in compensation related expense, primarily due to a shift in our collection workforce from the United States to India and a change in our compensation plan structure, and a decrease of \$0.4 million related to deferred compensation expense which was fully amortized in 2008, offset by an increase of \$0.2 million in personnel severance costs and an increase of \$0.5 million in health related expenses.

Stock-Based Compensation Expenses

Stock-based compensation expense increased by \$0.4 million, or 46.6%, to \$1.3 million during the three months ended September 30, 2009, from \$0.9 million for the three months ended September 30, 2008. This increase was a result of recent equity grants.

Stock-based compensation expense increased by \$0.1 million, or 4.8%, to \$3.3 million during the nine months ended September 30, 2009, from \$3.2 million for the nine months ended September 30, 2008. This increase was a result of recent equity grants, offset by the effect of the decreased fair value of stock options granted in recent years.

Cost of Legal Collections

The cost of legal collections increased \$0.7 million, or 2.8%, to \$26.1 million during the three months ended September 30, 2009, compared to \$25.4 million during the three months ended September 30, 2008. 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 \$5.8 million, or 11.7%, in gross collections through our legal channel, offset by decreased upfront litigation costs. Gross legal collections amounted to \$55.6 million during the three months ended September 30, 2009, up from \$49.8 million collected during the three months ended September 30, 2008. The cost of legal collections decreased as a percent of gross collections through this channel to 46.9% during the three months ended September 30, 2009, from 51.0% during the three months ended September 30, 2008, primarily due to the improvement in our ability to identify accounts that are more likely to result in collections through the legal channel, resulting in decreased court cost expense.

The cost of legal collections increased \$15.2 million, or 21.8%, to \$84.7 million during the nine months ended September 30, 2009, compared to \$69.5 million during the nine months ended September 30, 2008. 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 \$29.2 million, or 20.3%, in gross collections through our legal channel and upfront litigation costs. Gross legal collections amounted to \$173.5 million during the nine months ended September 30, 2009, compared to \$144.2 million collected during the nine months ended September 30, 2008. The cost of legal collections as a percent of gross collections through this channel increased to 48.8% during the nine months ended September 30, 2009, from 48.2% during the nine months ended September 30, 2008, due to an increase in upfront court cost expensed, as a percentage of collections, (and an increase in total dollars expensed) associated with our pursuit of legal collections.

Table of Contents

The following table summarizes our external collection channel performance and related direct costs (*in thousands, except percentages*):

	Legal Collections and related costs Three Months Ended September 30,				Legal Collections and related costs Nine Months Ended September 30,			
	2009		2008		2009		2008	
Collections	\$ 55,584	100.0%	\$ 49,765	100.0%	\$ 173,451	100.0%	\$ 144,241	100.0%
Court costs advanced	14,038	25.3%	16,860	33.9%	50,390	29.0%	46,033	31.9%
Court costs deferred	(6,056)	(10.9)%	(6,500)	(13.1)%	(18,552)	(10.7)%	(19,656)	(13.6)%
Deferred court costs reversal ⁽¹⁾	1,696	3.0%		0.0%	1,696	1.0%		0.0%
Court cost expense ⁽²⁾	9,678	17.4%	10,360	20.8%	33,534	19.3%	26,377	18.3%
Other ⁽³⁾	590	1.0%	578	1.2%	1,618	0.9%	1,711	1.2%
Commissions	15,824	28.5%	14,452	29.0%	49,512	28.6%	41,437	28.7%
Total Costs	\$ 26,092	46.9%	\$ 25,390	51.0%	\$ 84,664	48.8%	\$ 69,525	48.2%

(1) Primarily related to our arbitration settlement with Jefferson Capital in September 2009. As part of the settlement with Jefferson Capital, we returned accounts that were subject to Jefferson Capital's settlement with the FTC. A portion of those accounts were in our legal channel and, when these were returned, resulted in the reversal of court costs previously deferred. See Note 10 to our unaudited condensed consolidated financial statements for further information.

(2) 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. This amount includes changes in our anticipated recovery rate of court costs expensed.

(3) Other costs consist of costs related to counter claims and legal network subscription fees.

Other Operating Expenses

Other operating expenses remained consistent at \$6.0 million during the three months ended September 30, 2009 and 2008.

Other operating expenses increased \$0.9 million, or 5.4%, to \$18.6 million during the nine months ended September 30, 2009, from \$17.7 million during the nine months ended September 30, 2008. The increase was primarily the result of an increase of \$0.4 million in skip tracing expenses, an increase of \$0.3 million in direct mail campaign expenses, an increase of \$0.2 million in bank charges, an increase of \$0.2 million in recruiting costs, and an increase of \$0.2 million in telephone expenses. The increase was partially offset by a decrease of \$0.4 million in credit report notification costs.

Collection Agency Commissions

During the three months ended September 30, 2009, we incurred \$5.8 million in commissions to third party collection agencies, or 29.4% of the related gross collections of \$19.7 million compared to \$3.0 million in commissions, or 38.0% of the related gross collections of \$7.9 million, during the three months ended September 30, 2008. The increase in commissions was due to the increase in collections through this channel, partially offset by a lower net commission rate. The decrease in the net commission rate as a percentage of the related gross collections was primarily due to 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. Generally, freshly charged-off accounts have a lower commission rate than accounts that have been charged off for a longer period of time. During the three months ended September 30, 2009, the Company placed more freshly charged-off accounts with the agencies as compared to the same period in the prior year.

During the nine months ended September 30, 2009, we incurred \$13.5 million in commissions to third party collection agencies, or 31.4% of the related gross collections of \$42.9 million, compared to \$10.8 million in commissions, or 37.5% of the related gross collections of \$28.9 million, during the nine months ended September 30, 2008. The increase in commissions was due to the increase in collections through this channel,

partially offset by a lower net commission rate. The decrease in the net commission rate as a percentage of the related gross collections was primarily due to 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. General>

Mr. Antonio Silvino is an employee of Petrobras.

Observation

Manager of the issuer

549.964.227-34

Subordination

Supplier

HUBERT GEORG DEIERL

member of the Fiscal Board - alternate

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Hubert Deierl is an employee of Petrobras.

Observation

Manager of the issuer

263.201.427-15

Subordination

Supplier

Luiz Gonzaga do Monte Teixeira

member of the Fiscal Board - full member

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Luiz is an employee of Petrobras.

Observation

Manager of the issuer

Subordination

Indirect Controlling Shareholder

MANOEL MOTA FONSECA

019.638.218-15

full member of the Company's Fiscal Board

Related Person

15.105.588/0001-15

ODBINV S.A.

Mr. Manuel is alternate member of the fiscal board of ODBINV S.A.

Observation

Manager of the issuer

633.109.107-68

Subordination

Supplier

LAURA LOPES DE OLIVEIRA

member of the Board of Directors - alternate

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mrs. Laura is an employee of Petrobras.

Observation

Manager of the issuer

ANTONIO APARECIDA DE OLIVEIRA

370.844.456-68

Member of the Board of Directors - Full Member

Related Person

Subordination

Supplier

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Antonio Oliveira is an employee of Petrobras.

Observation

Manager of the issuer

ANDREA DAMIANI MAIA DE ANDRADE

245.431.308-12

Member of the Board of Directors - Full Member

Related Person

Subordination

Supplier

Petroleo Brasileiro S.A. - Petrobras

Mrs. Andrea Damiani is an employee of Petrobras.

Observation

Manager of the issuer

MARCUS VINICIUS DE OLIVEIRA MAGALHÃES

825.822.207-44

Member of the Board of Directors - alternate

Subordination

Supplier

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Marcus Vinicius is an employee of Petrobras.

Observation

Manager of the issuer

LUIS ADOLFO PEREIRA BECKSTEIN

080.739.427-04

member of the Board of Directors - alternate

Related Person

Subordination

Supplier

Petroleo Brasileiro S.A. - Petrobras

Mr. Luis Beckstein is an employee of Petrobras.

Observation

2013 Financial Year

Manager of the issuer

075.434.415-00

Subordination

Indirect Controlling Shareholder

ISMAEL CAMPOS DE ABREU

full member of the Fiscal Board

Related Person

ODBINV S.A.

15.105.588/0001-15

Mr. Ismael is board member of ODBINV S.A.

Observation

Manager of the issuer

263.201.427-15

Subordination

Supplier

Luiz Gonzaga do Monte Teixeira

member of the Fiscal Board - full member

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Luiz is an employee of Petrobras.

Observation

Manager of the issuer

663.780.367-72

Subordination

Supplier

MARCOS ANTONIO ZACARIAS

member of the Fiscal Board - full member

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Marcos Zacarias is an employee of Petrobras.

Observation

Manager of the issuer

549.964.227-34

Subordination

Supplier

HUBERT GEORG DEIERL

member of the Fiscal Board - alternate

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Hubert Deierl is an employee of Petrobras.

Observation

Manager of the issuer

633.109.107-68

Subordination

Supplier

LAURA LOPES DE OLIVEIRA

member of the Board of Directors - alternate

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mrs. Laura is an employee of Petrobras.

Observation

Manager of the issuer

ANTONIO APARECIDA DE OLIVEIRA

370.844.456-68

Subordination

Member of the Board of Directors - Full Member

Related Person

Supplier

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Antonio Oliveira is an employee of Petrobras.

Observation

Manager of the issuer

ANDREA DAMIANI MAIA DE ANDRADE

245.431.308-12

Subordination

Member of the Board of Directors - Full Member

Related Person

Supplier

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mrs. Andrea Damiani is an employee of Petrobras.

Observation

Manager of the issuer

LUIS ADOLFO PEREIRA BECKSTEIN

080.739.427-04

Subordination

Member of the Board of Directors - Alternate

Related Person

Supplier

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Luis Beckstein is an employee of Petrobras.

Observation

2012 Financial Year

Manager of the issuer

263.201.427-15

Subordination

Supplier

Luiz Gonzaga do Monte Teixeira

member of the Fiscal Board - full member

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Luiz is an employee of Petrobras.

Observation

Manager of the issuer

Subordination

Indirect Controlling Shareholder

MANOEL MOTA FONSECA

019.638.218-15

full member of the Company's Fiscal Board

Related Person

15.105.588/0001-15

ODBINV S.A.

Mr. Manuel is alternate member of the fiscal board of ODBINV S.A.

Observation

Manager of the issuer

663.780.367-72

Subordination

Supplier

MARCOS ANTONIO ZACARIAS

member of the Fiscal Board - full member

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Marcos Zacarias is an employee of Petrobras.

Observation

Manager of the issuer

633.109.107-68

Subordination

Supplier

LAURA LOPES DE OLIVEIRA

member of the Board of Directors - alternate

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mrs. Laura is an employee of Petrobras.

Observation

Manager of the issuer

370.844.456-68

Subordination

Supplier

ANTONIO APARECIDA DE OLIVEIRA

Member of the Board of Directors - Full Member

Related Person

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Antonio Oliveira is an employee of Petrobras.

Observation

Manager of the issuer

ANDREA DAMIANI MAIA DE ANDRADE

245.431.308-12

Subordination

Member of the Board of Directors - Full Member

Related Person

Supplier

Petroleo Brasileiro S.A. - Petrobras

Mrs. Andrea Damiani is an employee of Petrobras.

33.000.167/0001-01

Observation

Manager of the issuer

LUIS ADOLFO PEREIRA BECKSTEIN

080.739.427-04

Subordination

Member of the Board of Directors - Alternate

Related Person

Supplier

Petroleo Brasileiro S.A. - Petrobras

33.000.167/0001-01

Mr. Luis becksteinis an employee of Petrobras.

Observation

Proposal for Remuneration of Managers

(Required by article 12, of ICVM No. 481)

1. Proposal for Remuneration of Managers 2015

According to the Remuneration Policy approved by the Board of Directors, the proposal for global remuneration of the Statutory Managers of Braskem is based on:

The results of Executive Remuneration Study in order to place the monthly fees and other remuneration curves;

The Economic-Financial Indexes agreed for the year in order to define the apportionment of the results corresponding to the variable remuneration.

The annual amount proposed (period of 12 months) as Global Fees (Statutory Managers of Braskem) and respective charges, plus benefits for the year 2015, totalize R\$ **38.729** million, against R\$ 37.274 million for the year 2014.

The variations of the amounts regarding the proposal of 2015 and 2014 period are based on the estimate of the composition of the Managers' Fees according to the market reference, considering the monthly (increase due to the inflation and meritocracy), variable remuneration (in accordance with maturity and challenges) and short-term benefits.

2. Summary of the main variations 2015/ 2014

Managers

Board of Directors

7 statutory officers

11 board members and 11 alternate members
(R\$ in millions)

Discrimination	2015	2014
Fees	31.690	30,511
Short and Long Term Benefits	701	661
Charges	6.338	6,102
Total	38.729	37,274

Fiscal Board

5 board members and 5 alternate members (R\$ in millions)

Breakdown	2015	2014
Fees	584	549
Charges	117	110
Total	701	659

13.1 Remuneration policy and practice of the Board of Directors, the Statutory and Non-Statutory Executive Office, the Fiscal Board, the statutory committees and fiscal, risk, financial and remuneration committees.

(a) Objective of the Company's remuneration policy

The Company adopts a competitive and transparent remuneration system for all of its members, which seeks to attract and retain the best professionals in the market, as well as allow the collective and individual management of the remuneration its members. The Company remunerates its managers based on the market practices and in accordance with their duties and responsibilities in the actual running of the Company's business. In the case of Officers, the variable Remuneration Policy allows the sharing of risk and results of the Company with its main executives.

(b) Composition of the remuneration

(i) Description of the remuneration elements and their respective objectives:

Board of Directors and Fiscal Board

The sitting members of the Board of Directors and the Fiscal Board are remunerated by means of fees (fixed remuneration). Such form of remuneration aims to remunerate the members of the Board of Directors and Fiscal Board according to their duties and responsibilities in the actual running of the Company's business.

Statutory and Non-Statutory Executive Office

The members of the Statutory and Non-Statutory Executive Office are entitled to a monthly fixed remuneration and a variable remuneration, contingent upon both the individual

performance in overcoming the pre-agreed results as to the existence of economic results.

The Officers are also entitled to the benefits offered by the Company to all of its other members, such as medical and dental assistance, food and supplementary pension plan. Such benefits complement the remuneration package thereof, composing the total remuneration earned.

Statutory committees, audit, risk, financial and remuneration committees

The Company has three committees supporting the Board of Directors, namely: (i) Finance and Investment Committee; (ii) People and Organization Committee; and (iii) Strategy and Communication Committee. The committees are composed of the actual members of the Company's Board of Directors, who do not receive any additional remuneration for their participation in such committees.

(ii) proportion of each element in the total remuneration

Board of Directors and Fiscal Board

The remuneration of the members of the Board of Directors and the Fiscal Board is fixed, and fully composed of fees.

Statutory and Non-Statutory Executive Office

The total remuneration for this group is composed of approximately 37,5% in fixed remuneration, 60,5% in variable remuneration and 2% in benefits.

Statutory Committees, audit, risk, financial and remuneration committees

N/A

(iii) calculation and adjustment methodology of each one of the remuneration elements

Board of Directors

The monthly remuneration of directors is obtained through specialized surveys, by comparison with companies of similar size. The Company's policy is to meet the market median.

Fiscal Board

The monthly remuneration of directors is obtained through specialized surveys, by comparison with companies of similar size, with due regard to the minimum amount set forth by article 162, paragraph 3 of Law No. 6,404/76.

Statutory and Non-Statutory Executive Office

The monthly fixed remuneration of Officers is based on the market's average, the references of which are obtained through surveys involving companies with size similar to that of the Company.

The monthly fixed remuneration bands are determined based on:

- 85% of the market Median (Development Band)
 - Market Median in its central reference (Market's Target Band)
 - 115% of the market Median (Advanced Performance Band)
-

The variable remuneration results from the equation of the third quartile of the market's total remuneration, excluding the benefits and monthly fixed remuneration.

The Company offers the same benefits package to all of its members, including statutory and non-Statutory officers. The adjustments of amounts are the result of comparative studies that can be used as a basis to determine the need for a review.

Statutory Committees, audit, risk, financial and remuneration committees

N/A

(iv) reasons that justify the composition of the remuneration

Board of Directors

References are obtained through the results of specialized surveys conducted with companies of a size similar to that of the Company.

Fiscal Board

References are obtained through the results of specialized surveys conducted with companies of a size similar to that of the Company, with due regard to the legal provisions regarding the minimum remuneration.

Statutory and Non-Statutory Executive Office

The composition of the remuneration of the Company's Officers aims to attract and retain the best professionals, based on the market's practices regarding fixed, variable remuneration and the benefits package for each position. The Company has a more aggressive practice in relation to variable remuneration, as it understands that this way, it aligns the interests of officers with those of the Company, sharing the risks and results of the Company with its main executives.

The distribution of the remuneration between the fixed, variable portions and the benefits practiced in the year 2014 and anticipated for the year 2015 emphasize the variable remuneration and, thus, are in line with the objectives of the Remuneration Policy adopted by the Company.

Statutory committees, audit, risk, financial and remuneration committees

N/A

(c) Main performance indicators taken into account upon determination of each remuneration element

Board of Directors and Fiscal Board

N/A

Statutory and Non-Statutory Executive Office

The classification of monthly remuneration of each Officer depends on the assessment of the complexity of his/her program, as well as the individual performance thereof. The variable remuneration, in turn, is conditioned on the achievement of internal targets and the economic performance of the Company, taking into account the following elements: (i) Operational EBITDA, (ii) Working Capital Variation, (iii) Payment of Dividends.

Statutory Committees, audit, risk, financial and remuneration committees

N/A

(d) How the remuneration is structured in order to reflect the evolution of the performance indicators

Board of Directors and Fiscal Board

N/A

Statutory and Non-Statutory Executive Office

The changes of remuneration items are directly related to the individual performance and the performance of the Company and the achievement of the targets established for a given period.

Statutory Committees, audit, risk, financial and remuneration committees

N/A

(e) How the remuneration policy or practice is aligned with the interests of the issuer in the short, medium and long terms

The remuneration strategy is pegged to factors and premises that make it more equitable (remunerate proportionally, according to the skills, professional qualification and impact on results), competitive (suitable to market standards), efficient (regarding the costs for the Company) and safe (committed to the continuity of the business). To the extent that the short, medium and long term targets are met, more results are generated for the Company, which, in turn, distributes such results in the form of fixed short term remuneration, medium term variable remuneration and, as the case may be, of long term incentives. This cycle makes the Company grow and develop in pursuit of its perpetuity.

(f) Existence of remuneration supported by direct and indirect subsidiaries, controlled or controlling companies.

Board of Directors and Fiscal Board

None.

Statutory and Non-Statutory Executive Office

None

Statutory Committees, audit, risk, financial and remuneration committees

N/A

(g) Existence of any remuneration or benefit linked to the occurrence of a given corporate event, such as the disposal of corporate control of the issuer

There are no remuneration elements associated with the occurrence of corporate events.

13.2 Information on the remuneration recognized in the results for the last 3 financial years and the remuneration set forth for the current financial year of the Board of Directors, the Statutory Executive Office and the Fiscal Board

2015

	Board of Directors (Sitting Members)	Statutory Executive Office	Fiscal Board (Sitting Members)	Total
Number of Members¹	11	7	5	23
Annual Fixed Remuneration (R\$)	2.858.694	13.644.853	701.640	17.205.187
Salary / <i>Pro labore</i>	2.382.245	11.183.195	584.700	14.150.140
Direct and indirect benefits	N/A	225.019	N/A	225.019
Participation in committees	N/A	N/A	N/A	N/A
Others	476.449	2.236.639	116.940	2.830.028
Variable Remuneration	N/A	21.750.000	N/A	21.750.000
Bonus	N/A	N/A	N/A	N/A
Profit sharing	N/A	18.125.000	N/A	18.125.000
Participation in meetings	N/A	N/A	N/A	N/A
Commissions	N/A	N/A	N/A	N/A
Others	N/A	3.625.000	N/A	3.625.000
Post-employment benefits	N/A	476.156	N/A	476.156
Benefits due to the cessation of office	N/A	N/A	N/A	N/A
Stock-based remuneration	N/A	0.00	N/A	N/A
Total	2.858.694	35.871.009	701.640	39.431.343

(1) In compliance with the CVM instructions, the annual average of the number of members of each body was calculated.

(2) The amounts related to social security and labor charges. In the table above, "N/A" means that the Company does not have in the year in reference the respective type of remuneration for the referred body.

2014

	Board of Directors (Sitting Members)	Statutory Executive Office	Fiscal Board (Sitting Members)	Total
Number of Members¹	11	7	5	23
Annual Fixed Remuneration (R\$)	2.335.974	9.077.677	527.587	11.941.238
Salary / <i>Pro labore</i>	1.946.645	7.415.024	439.656	9.801.325
Direct and indirect benefits	N/A	179.648	N/A	179.648
Participation in committees	N/A	N/A	N/A	N/A
Others	389.329	1.483.005	87.931	1.960.265
Variable Remuneration	N/A	18.637.557	N/A	18.637.557
Bonus	N/A	N/A	N/A	N/A
Profit sharing ⁽³⁾	N/A	15.531.298	N/A	15.531.298
Participation in meetings	N/A	N/A	N/A	N/A
Commissions	N/A	N/A	N/A	N/A
Others	N/A	3.106.259	N/A	3.106.259
Post-employment benefits	N/A	276.616	N/A	276.616
Benefits due to the cessation of office	N/A	N/A	N/A	N/A
Stock-based remuneration	N/A	0.00	N/A	N/A
Total	2.335.974	27.991.850	527.588	30.855.411

(1) In compliance with the CVM instructions, the annual average of the number of members of each body was calculated.

(2) The amounts related to social security and labor charges. In the table above, "N/A" means that the Company does not have in the year in reference the respective type of remuneration for the referred body.

(3) Amount actually recognized in the 2014 result that will be paid in 2015.

Obs: Note that any differences between the actual value accounted for in 2014 and the amounts proposed may be due to the following factors: (i) non-use of the total contingency fees of funds for fixed and variable fees; and (ii) resignation by one of the members of the Board of his fees.

2013

	Board of Directors (Sitting members)	Statutory Executive Office	Fiscal Board (Sitting members)	Total
Number of Members¹	10.00	6.75	4.00	20.75
Annual Fixed Remuneration (R\$)	2,155,568	9,188,656	478,951	11,823,175
Salary / <i>Pro Labore</i>	1,796,306	7,505,306	399,125	9,700,738
Direct and indirect benefits	N/A	182,289	N/A	182,289
Participation in committees	N/A	N/A	N/A	N/A
Others	359,261	1,501,061	79,825	1,940,147
Variable Remuneration	N/A	16,740,000	N/A	16,740,000
Bonus	N/A	N/A	N/A	N/A
Profit sharing ³	N/A	13,950,000	N/A	13,950,000
Participation in meetings	N/A	N/A	N/A	N/A
Commissions	N/A	N/A	N/A	N/A
Others ²	N/A	2,790,000	N/A	2,790,000
Post-employment benefits	N/A	249,356	N/A	249,356
Benefits due to the cessation of office	N/A	N/A	N/A	N/A
Stock-based remuneration	N/A	0.00	N/A	0.00
Total³	2,155,568	28,968,013	478,951	31,602,532

(1) In compliance with the CVM instructions, the annual average of the number of members of each body was calculated.

(2) Amounts related to social security and labor charges.

Obs: Note that any differences between the actual value accounted for in 2014 and the amounts proposed may be due to the following factors: (i) non-use of the total contingency fees of funds for fixed and variable fees; and (ii) resignation by one of the members of the Board of his fees.

In the table above, "N/A" means that the Company does not have in the year in reference the respective type of remuneration for the referred body.

2012

	Board of Directors (Sitting members)	Statutory Executive Office	Fiscal Board (Sitting members)	Total
Number of Members¹	10.58	6.58	5	22.16
Annual Fixed Remuneration (R\$)	2,148,439	8,498,444	449,518	11,096,402
Salary / <i>Pro Labore</i>	1,790,366	6,825,436	374,598	8,990,400
Direct and indirect benefits	N/A	122,358	N/A	122,358
Participation in committees	N/A	N/A	N/A	N/A
Others ²	358,073	1,550,650.02	74,919	1,983,642
Variable Remuneration	N/A	13,789,034	N/A	13,789,034
Bonus	N/A	N/A	N/A	N/A
Profit sharing	N/A	11,490,862	N/A	11,490,862
Participation in meetings	N/A	N/A	N/A	N/A
Commissions	N/A	N/A	N/A	N/A
Others ²	N/A	2,298,172	N/A	2,298,172
Post-employment benefits	N/A	274,682	N/A	274,682
Benefits due to the cessation of office	N/A	N/A	N/A	N/A
Stock-based remuneration	N/A	0.00	N/A	0.00
Total	2,148,439	22,562,161	449,518	25,160,119

(1) In compliance with the CVM instructions, the annual average of the number of members of each body was calculated.

(2) Amounts related to social security and labor charges.

Obs: Note that any differences between the actual value accounted for in 2014 and the amounts proposed may be due to the following factors: (i) non-use of the total contingency fees of funds for fixed and variable fees; and (ii) resignation by one of the members of the Board of his fees.

In the table above, "N/A" means that the Company does not have in the year in reference the respective type of remuneration for the referred body.

13.3 Information on the variable remuneration of the last 3 financial years and that estimated for the current financial year of the Board of Directors, the Statutory Executive Office and the Fiscal Board

2015

	Board of Directors (Sitting Members)	Statutory Executive Office	Fiscal Board (Sitting Members)	Total
Number of Members¹	11	7	5	23
Bonus				
Minimum amount established in the remuneration plan	N/A	N/A	N/A	N/A
Maximum amount established in the remuneration plan	N/A	N/A	N/A	N/A
Amount established in the remuneration plan – targets achieved	N/A	N/A	N/A	N/A
Amount actually recognized	N/A	N/A	N/A	N/A
Profit sharing				
Minimum amount established in the remuneration plan	N/A	0,00	N/A	N/A
Maximum amount established in the	N/A	18.850.000²	N/A	18.850.000

remuneration plan				
Amount established in the remuneration plan – targets achieved	N/A	14.500.000 ²	N/A	14.500.000
Amount actually recognized	N/A	N/A	N/A	N/A

(1) In compliance with the CVM instructions, the annual average of the number of members of each body was calculated, based on January 2012.

In the table above, "N/A" means that the Company does not have in the year in reference the respective type of remuneration for the referred body.

(2) Does not include amounts related to social security and labor charges, just the profit sharing

2014

	Board of Directors (Sitting Members)	Statutory Executive Office	Fiscal Board (Sitting Members)	Total
Number of Members¹	11	7	5	23
Bonus				
Minimum amount established in the remuneration plan	N/A	N/A	N/A	N/A
Maximum amount established in the remuneration plan	N/A	N/A	N/A	N/A
Amount established in the remuneration plan – targets achieved	N/A	N/A	N/A	N/A
Amount actually recognized	N/A	N/A	N/A	N/A
Profit sharing				
Minimum amount established in the remuneration plan	N/A	0,00	N/A	N/A
Maximum amount established in the remuneration plan	N/A	18,200,000²	N/A	18,200,000
Amount established in the remuneration plan – targets achieved	N/A	14,000,000 ²	N/A	14,000,000
Amount actually recognized	N/A	15.531.298 ²	N/A	15.531.298

(1) In compliance with the CVM instructions, the annual average of the number of members of each body was calculated, based on January 2012.

(2) Does not include amounts related to social security and labor charges, just the profit sharing

In the table above, "N/A" means that the Company does not have in the year in reference the respective type of remuneration for the referred body.

2013

	Board of Directors (Sitting Members)	Statutory Executive Office	Fiscal Board (Sitting Members)	Total
Number of Members¹	10.00	6.75	4.00	20.75
Bonus				
Minimum amount established in the remuneration plan	N/A	N/A	N/A	N/A
Maximum amount established in the remuneration plan	N/A	N/A	N/A	N/A
Amount established in the remuneration plan – targets achieved	N/A	N/A	N/A	N/A
Amount actually recognized	N/A	N/A	N/A	N/A
Profit sharing				
Minimum amount established in the remuneration plan	N/A	0.00	N/A	N/A
Maximum amount established in the remuneration plan	N/A	18,135,000²	N/A	18,135,000
Amount established in the remuneration plan – targets achieved	N/A	13,950,000	N/A	13,950,000
Amount actually recognized	N/A	13,950,000	N/A	13,950,000

(1) In compliance with the CVM instructions, the annual average of the number of members of each body was calculated based on January 2012.

(2) Does not include amounts related to social security and labor charges, just the profit sharing

In the table above, "N/A" means that the Company does not have in the year in reference the respective type of remuneration for the referred body.

2012

	Board of Directors (Sitting Members)	Statutory Executive Office	Fiscal Board (Sitting Members)	Total
Number of Members ¹	11	6.58	5	23
Bonus				
Minimum amount established in the remuneration plan	N/A	N/A	N/A	N/A
Maximum amount established in the remuneration plan	N/A	N/A	N/A	N/A
Amount established in the remuneration plan – targets achieved	N/A	N/A	N/A	N/A
Amount actually recognized	N/A	N/A	N/A	N/A
Profit sharing				
Minimum amount established in the remuneration plan	N/A	0,00	N/A	N/A
Maximum amount established in the remuneration plan	N/A	16,600,000 ²	N/A	16,600,000
Amount established in the remuneration plan – targets achieved	N/A	12,750,000	N/A	12,750,000
Amount actually recognized	N/A	11,490,862	N/A	11,490,862

(1) In compliance with the CVM instructions, the annual average of the number of members of each body was calculated, based on January 2012.

In the table above, “N/A” means that the Company does not have in the year in reference the respective type of remuneration for the referred body.

(2) Does not include amounts related to social security and labor charges, just the profit sharing

13.4 Stock-based remuneration plan of the Board of Directors and of the Statutory Executive Office, in force in the last financial year and established for the current financial year

Board of Directors

The Company did not have in the last financial year and does not have in the current financial year a stock-based remuneration plan for the members of the Board of Directors.

Statutory Executive Office:

The Long Term Variable Remuneration was extinguished in 2014¹ and the company does not have therefore, a currently plan.

(1) The termination of the plan was approved by Braskem Board of Directors at RCA on May, 07 2014.

(a) General terms and conditions

N/A

(b) Main objectives of the plan

N/A

(c) How the plan contributes to such objectives

N/A

(d) How the plan is inserted in the issuer's remuneration policy

N/A

(e) How the plan aligns the interests of the managers and the issuer on the short, medium and long run

N/A

(f) Maximum number of shares covered

N/A

(g) Maximum number of shares to be granted

N/A

(h) Conditions to acquire shares

N/A

(i) Criteria to determine the purchase price or exercise

N/A

(j) Criteria to establish the term of exercise

N/A

(k) Form of settlement

N/A

(l) Restrictions to the transfer of shares

N/A

(m) Criteria and events that, when verified, will entail the suspension, alteration or extinguishment of the plan

N/A

(n) Effects of the withdrawal of the manager from the issuer's bodies on the rights set out in the stock-based remuneration plan

N/A

13.5 Number of shares or quotas directly or indirectly held, in Brazil or abroad, and other securities convertible into shares or quotas, issued by the issuer, its direct or indirect controlling companies, controlled companies or companies under common control, by members of the Board of Directors, of the Statutory Executive Office or of the Fiscal Board, on the end date of the last financial year

Shares issued by the Company

Board of Directors

Common shares: 100

Class A preferred shares: 67.526

Statutory Executive Office

Class A preferred shares: 8,948

Fiscal Board

Class A preferred shares: 100

Shares or quotas issued by the direct or indirect controlling companies of the Company

Board of Directors

ODBINV S.A. – 1,683,394,556 common shares

EAO Patrimonial Ltda. – 527,809 quotas

ODBP1 1 S.A. – 1,995,010,474 preferred shares

ODBP2 2 S.A. – 324,220,120 common shares

Statutory Executive Office

The members of the Statutory Executive Office are not holders of securities issued by the direct or indirect controlling companies of the Company.

Fiscal Board

The members of the Fiscal Board are not holders of securities issued by the direct or indirect controlling companies of the Company.

Shares or quotas issued by the controlled companies or companies under common control with the Company

Board of Directors

The members of the Board of Directors of the Company are not holders of securities issued by the controlled companies or companies under common control with the Company.

Statutory Executive Office

The members of *Statutory Executive Office* of the Company are not holders of securities issued by the controlled companies or companies under common control with the Company.

Fiscal Board

The members of the Fiscal Board are not holders of securities issued by the controlled companies or companies under common control with the Company.

13.6 Information on the stock-based remuneration recognized in the results for the last 3 financial years and the remuneration for the current financial year, of the Board of Directors and of the Statutory Executive Office

Stock-based remuneration established for the current financial year (2015)

	Board of Directors	Statutory Executive Office
No. of members	NA	NA
Granting of stock options	NA	NA
Granting date	NA	NA
Quantity of options granted	NA	NA
Term for the options to become exercisable	NA	NA
Maximum term for exercise of the options	NA	NA

Term for restriction on transfer of shares	NA	NA
Weighted average price for exercise:	NA	NA
(a) Outstanding options in the beginning of the financial year	NA	NA
(b) Options lost during the financial year	NA	NA
(c) Options exercised during the financial year	NA	NA
(d) Options expired during the financial year	NA	NA
Fair value of the options on the granting date	NA	NA
Potential dilution in the case of exercise of all options granted	NA	NA

(1) The termination of the plan was approved by Braskem Board of Directors at RCA on May, 07 2014.

Stock-based remuneration established for the financial year ended on December 31, 2014

	Board of Directors	Statutory Executive Office
No. of members	NA	2
Granting of stock options	NA	NA
Granting date	NA	None, in the last 3 years
Quantity of options granted	NA	None, in the last 3 years
Term for the options to become exercisable	NA	NA
Maximum term for exercise of the options	NA	NA
Term for restriction on transfer of shares	NA	NA
Weighted average price for exercise.	NA	NA
(a) Outstanding options in the beginning of the financial year	NA	NA
(b) Options lost during the financial year	NA	NA
(c) Options exercised during the financial year	NA	NA
(d) Options expired during the financial year	NA	NA
Fair value of the options on the granting date	NA	NA
Potential dilution in the case of exercise of all options	NA	NA

granted

13.7 Information on the outstanding options of the Board of Directors and of the Statutory Executive Office at the end of the latest financial year

	Board of Directors	Statutory Executive Office
Outstanding options at the end of the financial year ended on December 31, 2014 ¹		
No. of members	NA	NA
Options not yet exercised	NA	NA
Quantity	NA	NA
Date that they will become exercisable	NA	NA
Maximum term for exercise of the options	NA	NA
Term of restriction on transfer of shares	NA	NA
Weighted average price for exercise	NA	NA
Fair value of the options on the last day of the financial year	NA	NA
Exercisable Options	NA	NA
Quantity	NA	NA
Maximum term for exercise of the options	NA	NA
Term of restriction on transfer of shares	NA	NA
Weighted average price for exercise	NA	NA
Fair value of the options on the last day of the financial year	NA	NA
Fair value of the total options on the last day of the financial year	NA	NA

(1) The termination of the plan was approved by Braskem Board of Directors at RCA on May, 07 2014.

13.8 Information on the options exercised and the shares delivered with respect to the stock-based remuneration of the Board of Directors and of the Statutory Executive Office

Options exercised – financial year ended on December 31, 2014¹

	Board of Directors	Statutory Executive Office
No. of members	NA	2
Options exercised	NA	2
		In 2014 ² : 80,153 UI's
Number of shares	NA	In 2013: 2055 UI's In 2012: 12,039 UI's In 2014: R\$ 18.88
Weighted average price of exercise	NA	In 2013: R\$ 13.93 In 2012: R\$ 14.51
Difference between the exercise value and the market value for the shares related to the options exercised	NA	Not applicable, as the UI does not refer to the market real value
Shares delivered	NA	
Number of shares delivered	NA	There was no other purchase option/delivery in the last 3 years and as from 2008.
Weighted average price for acquisition	NA	NA
Difference between the acquisition value and the market value for the shares acquired	NA	NA

(1) The termination of the plan was approved by Braskem Board of Directors at RCA on May, 07 2014.

(2) Total amount redemption exercised by Statutory Executive Office members regarding the termination of the plan.

13.9 Information required in order to understand the data disclosed in items 13.6 to 13.8, such as the explanation of the pricing method for the value of the shares and options.

13.9.1 Pricing Method

ALFA value based, in average, on 6 months (October to March each year) of the BRKM5 share quote. Amount frozen for 1 year (until the end of March of the next year).

13.9.2 Data and premises used in the pricing method, including the weighted average price for the shares, exercise price, expected volatility, term of effectiveness of the option, expected dividends and risk-free interest rate

Option Pricing (Beta Certificate) – Black & Scholes

- a) Share value on the calculation base date: average of 6 months (October to March each year) of the BRKM5 quote
- b) Strike - zero value since there will be no disbursement on the part of the employee
- c) Time – the "implementation" of the plan will take place in 10 years
- d) Risk-free – rate free of risk (current Meta Selic)
- e) Volatility – calculated based on the share price for the last 3 years
- f) Dividends Yield – ascertained based on the business plan (6% in perpetuity)

13.9.3 Method used and premises assumed to incorporate the expected effects of early exercise

The effects of the offsetting of the Plan are calculated every quarter, where one (01) share of Braskem represents "Alfa" and "Gama" investment certificates and one (01) Beta share represents one share of Braskem "less" the dividends paid. The alfa units are multiplied by the share price (average of 6 months) and the beta units are multiplied by the option premium. The sum of the fair value of alfa + beta is deducted from the historical value of the options and the amount is accrued for in the balance sheet.

13.9.4 Method of determination of the expected volatility

Calculated based on the BRKM5 share price for the last 3 years.

13.9.5 If any other characteristic of the option was incorporated in the calculation of its fair value

The option is being calculated by the Black & Scholes method. There is no other characteristic.

13.10 Information on the social security plans in force granted to the members of the Board of Directors and the statutory officers

	Board of Directors (Sitting Members)	Statutory Executive Office	Fiscal Board (Sitting Members)
Number of Members	11	7	5
Name of the plan	N/A	Odebrecht Previdência	N/A
Quantity of managers eligible for retirement	N/A	0	N/A
Conditions for early retirement	N/A	There is no possibility of early retirement	N/A
Updated amount of the contributions accumulated in the social security plan until the end of the last financial year, deducting the portion related to contributions made directly by the managers	N/A	1.202.779 ¹	N/A
Total accumulated amount of the contributions made during the last financial year, deducting the portion related to contributions made directly by the managers	N/A	276.616	N/A
Possibility of early redemption and conditions	N/A	There is no possibility of early redemption	N/A

In the table above, "N/A" means that the Company does not have a social security plan for the body in reference.

(1) Lower amount than the last result due the change in the Statutory Executive Office members

13.11 Information on the Board of Directors, Statutory Executive Office and Fiscal Board

Item not disclosed, based on the injunction granted by the honorable judge of the 5th Lower Federal Court/RJ, in the records of proceeding 2010.5101002888-5.

13.12 Contractual arrangements, insurance policies and other instruments structuring remuneration or indemnification mechanisms for the managers in the event of dismissal from office or retirement.

There are no contractual arrangements, insurance policies or other instruments that make up remuneration or indemnification mechanisms for the managers in the event of dismissal from office or retirement.

13.13 Percentage of the total remuneration of each body recognized in the Company's results referring to the members of the Board of Directors, of the Statutory Executive Office or of the Fiscal Board, which are parties related to the direct or indirect controlling companies, according to accounting rules.

2014

Board of Directors: 31,00%

Fiscal Board: 00.00%

Statutory Executive Office: 0.00%

2013

Board of Directors: 24.04%

Fiscal Board: 50.00%

Statutory Executive Office: 0.00%

2012

Board of Directors: 20.26%

Fiscal Board: 25.00%

Statutory Executive Office: 0.00%

13.14 Remuneration amounts of the members of the Board of Directors, the Statutory Executive Office and the Fiscal Board, which do not result from the positions occupied thereby.

No remuneration is paid to the members of the Board of Directors, the Statutory Executive Office or the Fiscal Board for any reason other than the position occupied thereby in the Company.

13.15 Amounts recognized in the results of direct or indirect controlling companies, controlled companies and companies under common control with the Company, such as remuneration of members of the Board of Directors, the Statutory Executive Office or the Fiscal Board of the Company

In the year 2014, the totality of the remuneration of the members of the Board of Directors, the Statutory Executive Office and the Fiscal Board of the Company was recognized in the Company's results.

In the year 2013, the totality of the remuneration of the members of the Board of Directors, the Statutory Executive Office and the Fiscal Board of the Company was recognized in the Company's results.

In the year 2012, the totality of the remuneration of the members of the Board of Directors, the Statutory Executive Office and the Fiscal Board of the Company was recognized in the Company's results.

13.16 Other relevant information

All relevant information concerning the remuneration of the managers was disclosed in the previous items of this Chapter of the Reference Form of the Company.

**Proposal for the allocation of net income for fiscal year 2014
(as per Attachment 9-1-II of CVM Instruction 481/2009)**

The Management of the Company hereby presents the information required under Attachment 9-1-II of CVM Instruction 481:

1. Net income for the fiscal year:

The net income for fiscal year of the Braskem S.A. (parent Company) in 2014 was R\$864,064 thousand.

2. Total amount and amount per share of the dividends, including any dividends prepaid and interest on equity already declared:

The global amount of dividends is R\$482,593 thousand. The proposed amount of dividends per share is R\$0.606188802.

3. Percentage of net income distributed in the fiscal year

Management proposes the payment of total dividends corresponding to 54% of adjusted net income for the calculation of dividends.

4. Total amount and amount per share of the dividends distributed based on net income in prior fiscal years:

There was no distribution of dividends or declaration of interest on equity based on net income for prior fiscal years.

5. (a) Information on the gross amount per share of dividends and interest on equity, separately for each type and class of share, to be distributed/declared at the annual shareholders' meeting:

The proposed dividend per share is R\$0.06188802 for the common shares and class "A" and class "B" preferred shares, which corresponds to:

R\$273,796 thousand for the common shares;

R\$208,437 thousand for the class "A" preferred shares; and

R\$360 thousand for the class "B" preferred shares.

Is important to note that this item refers to proposed dividend per share. Therefore, the above values are different from those in the 7(a) item (net income per share), in the view of retention for legal reserve and to attend the capital budget.

(b) Information on the form and date for the payment of dividends and interest on equity to be distributed/declared at the annual shareholders' meeting:

The Management will propose to the Shareholders' Meeting to be held on April 9, 2015 the payment of the full amount of dividends on April 2015.

(c) Information on any restatement and interest on the dividends and interest on equity to be distributed/declared at the annual shareholders' meeting:

No restatement or interest on dividends to be declared at the Shareholders' Meeting.

(d) Information on the declaration date of the payment of dividends and interest on equity considered for identifying those shareholders entitled to receive dividends and interest on equity distributed/declared at the annual shareholders' meeting:

The declaration of dividends to be distributed is subject to shareholders approval in the Shareholders' Meeting to be held on April 9, 2015. Once approved, the date of the declaration will be April 9, 2015.

6. Information on the dividends or interest on equity declared based on net income calculated on semiannual balance sheets or statements for shorter periods:

Not applicable. There was no prepayment of dividends or declaration of interest on equity based on the net income calculated by semiannual balance sheets or statements for shorter periods.

7. (a) Comparison table indicating the net income for the fiscal year and for the three (3) prior fiscal years by share of each type and class, presented in thousands of reais:

	2014	2013	2012	2011
Profit (loss) for the year	864,063	509,697	(731,143)	(525,142)
Number of shares:				
Common	451,669	451,669	451,669	451,669
Class "A" preferred shares	343,848	343,848	344,600	346,451
Class "B" preferred shares	594	594	594	594
Profit (loss) per share (in R\$)				
Common	1.0857152	0.6402594	(1.2717949)	(0.6565666)
Class "A" preferred shares	1.0857152	0.6402594	(1.2717949)	(0.6565666)
Class "B" preferred shares	0.6062464	0.6062464	(1.2717949)	(0.6565666)

This item refers to net income per share, which differs from the dividend per share stated in item 5(a). The difference arises from non distribution of all net income, considering the deductions for legal reserve and profit reserves.

7. (b) Comparison table indicating the dividends and interest on equity declared/distributed for the three (3) previous fiscal years by each type and class of share:

	Common Shares		Class "A" preferred shares		Class "B" preferred shares	
	Dividends	Interest on capital receivable	Dividends	Interest on capital receivable	Dividends	Interest on capital receivable
Year ended in 31.12.2011	0,60508505	0	0,60508505	0	0,60508505	0
Year ended in 31.12.2012	0	0	0	0	0	0
Year ended in 31.12.2013	0,60618880	0	0,60618880	0	0,60618880	0
Year ended in 31.12.2014	0,60618880	0	0,60618880	0	0,60618880	0

8. (a) Amount allocated to the legal reserve:

The amount allocated R\$44,647 thousand to the legal reserve.

(b) Method for calculating the legal reserve:

	2014
Net income for the year of attributable to parent Company's shareholders	864,064
Amounts recorded directly to retained earnings	
Realization of additional property, plant and equipment	28,203
Prescribed dividends	682
	892,949
Legal reserves distribution	(44,647)
	848,302

9. (a) Description of the method for calculating the fixed or minimum dividends:

In accordance with the Bylaws of the Braskem, the preferred shares are entitled to the payment of a minimum, non-cumulative priority dividend of six percent (6%) of their "unit value" based on the net income available for distribution. Only the class "A" preferred shares are entitled to participate on an equal basis with the common shares in the distribution of the remaining net income, and these shares are only entitled to the dividend after payment of the priority dividend to the preferred shares. Only the class "A" preferred shares are also assured equal conditions to the common shares in the distribution of shares resulting from capitalization of other reserves. On the other hand, the bylaws provide for the payment of the non-cumulative, minimum mandatory dividend equivalent to 25% of the net income adjusted in accordance with Brazilian Corporations Law. This amount of dividend calculated on adjusted net income, as described in item 10(a), is R\$212,076 thousand.

(b) Information on whether the net income for the fiscal year is sufficient for the full payment of the fixed or minimum dividends:

The net income for fiscal year 2014 attributable to parent Company's shareholders is sufficient for the full payment of the minimum dividends.

(c) Information on any unpaid portion being cumulative:

In accordance with the Bylaws of the Braskem, the priority dividend is not cumulative.

(d) Information on the total amount of fixed or minimum dividends to be paid for

each class of preferred shares:

The total amount of dividends proposed for the preferred shares is equivalent to the priority dividend provided for in the Bylaws, and assemble R\$208,437 thousand and R\$594 thousand for the class "A" and "B" preferred shares, respectively.

(e) Information on the amount of fixed or minimum dividends to be paid for each class of preferred share:

The unit value of dividend proposed for the class "A" and class "B" preferred shares is equivalent to the priority dividend provided for in the Bylaws and assemble R\$0.6061888020 for both classes.

10. (a) Description of the method for calculating the mandatory dividend provided for in the bylaws:

Shareholders are entitled to receive as the mandatory dividend an amount corresponding to twenty-five percent (25%) of the net income for the fiscal year adjusted in accordance with Brazilian Corporations Law. The calculation of said dividends for fiscal year 2014, presented in thousands of reais, is shown below:

	2014
Net income for the year of attributable to parent Company's shareholders	864,064
Amounts recorded directly to retained earnings	
Realization of additional property, plant and equipment	28,203
Prescribed dividends	682
	892,949
Legal reserves distribution	(44,647)
	848,302
Destinations:	
Proposed dividends	(482,593)
Portion allocated to unrealized profit reserves	(365,709)
	(848,302)
<u>Composition of the total proposed dividends</u>	
Minimum dividends - 25% adjusted net income	(212.076)
Additional proposed dividends	(270.517)
Total dividends	(482.593)

(b) Information on whether the mandatory dividend is being paid in full:

The dividends proposed by the Management exceed the minimum mandatory dividend.

(c) Information on any amount withheld as a result of the financial situation of the Company:

No amount has been withheld due to the Braskem financial condition.

11. Information on whether the mandatory dividend was withheld due to the financial situation of the Company:

No amount has been withheld due to the financial situation of the Braskem.

12. Information on the allocation of net income to the contingency reserve:

No amounts have been allocated to the contingency reserve.

13. Amount allocated to the unearned profit reserve:

(i) No amounts have been allocated to the unearned profit reserve.

14. Information on the allocation of net income to reserves established by the bylaws:

No portion of net income was allocated to reserves established by the bylaws.

15. Information on the withholding of net income provided for in the capital budget:

a) identify the amount withheld:

The amount of retained earnings based on capital budget was R\$365,709 thousand.

b) provide a copy of the capital budget:

SOURCES OF FUNDS	
Own resources, including retained earnings (Article 196 of Law 6,404/76) and third-party funds	2,333,311

INVESTMENTS	
Maintenance/Replacement/Equipments/ Security/Prevention/Expansion Projects /Other	2,333,311

16. Amount allocated to the fiscal incentive reserve:

No amount was allocated to fiscal incentives.

