

ENCORE CAPITAL GROUP INC

Form 10-Q

May 10, 2016

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2016

OR

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER: 000-26489

ENCORE CAPITAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware 48-1090909

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

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

(Address of principal executive offices) (Zip code)

(877) 445 - 4581

(Registrant's telephone number, including area code)

(Not Applicable)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" 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.

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Class	Outstanding at May 3, 2016
Common Stock, \$0.01 par value	25,518,443 shares

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PART I – FINANCIAL INFORMATION

Item 1—Condensed Consolidated Financial Statements (Unaudited)

ENCORE CAPITAL GROUP, INC.

Condensed Consolidated Statements of Financial Condition

(In Thousands, Except Par Value Amounts)

(Unaudited)

	March 31, 2016	December 31, 2015
Assets		
Cash and cash equivalents	\$ 144,613	\$ 123,993
Investment in receivable portfolios, net	2,486,978	2,440,669
Property and equipment, net	68,162	72,546
Deferred court costs, net	75,829	75,239
Other assets	157,533	148,762
Goodwill	890,504	924,847
Assets associated with discontinued operations	—	388,763
Total assets	\$ 3,823,619	\$ 4,174,819
Liabilities and equity		
Liabilities:		
Accounts payable and accrued liabilities	\$ 238,203	\$ 290,608
Debt	2,893,434	2,944,063
Other liabilities	27,975	59,226
Liabilities associated with discontinued operations	—	232,434
Total liabilities	3,159,612	3,526,331
Commitments and contingencies		
Redeemable noncontrolling interest	39,948	38,624
Redeemable equity component of convertible senior notes	5,359	6,126
Equity:		
Convertible preferred stock, \$.01 par value, 5,000 shares authorized, no shares issued and outstanding	—	—
Common stock, \$.01 par value, 50,000 shares authorized, 25,508 shares and 25,288 shares issued and outstanding as of March 31, 2016 and December 31, 2015, respectively	255	253
Additional paid-in capital	109,228	110,533
Accumulated earnings	569,183	543,489
Accumulated other comprehensive loss	(68,360)	(57,822)
Total Encore Capital Group, Inc. stockholders' equity	610,306	596,453
Noncontrolling interest	8,394	7,285
Total equity	618,700	603,738
Total liabilities, redeemable equity and equity	\$ 3,823,619	\$ 4,174,819

The following table includes assets that can only be used to settle the liabilities of the Company's consolidated variable interest entities ("VIEs") and the creditors of the VIEs have no recourse to the Company. These assets and liabilities are included in the consolidated statements of financial condition above. See Note 11, "Variable Interest Entities" for additional information on the Company's VIEs.

	March 31, 2016	December 31, 2015
Assets		
Cash and cash equivalents	\$ 62,539	\$ 50,483
Investment in receivable portfolios, net	1,217,625	1,197,513
Property and equipment, net	18,145	19,767

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Deferred court costs, net	35,782	33,296
Other assets	46,804	31,679
Goodwill	680,727	706,812
Assets associated with discontinued operations	—	92,985
Liabilities		
Accounts payable and accrued liabilities	\$ 99,010	\$ 142,375
Debt	1,739,579	1,665,009
Other liabilities	687	839
Liabilities associated with discontinued operations	—	58,923
See accompanying notes to condensed consolidated financial statements		

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ENCORE CAPITAL GROUP, INC.

Condensed Consolidated Statements of Operations

(In Thousands, Except Per Share Amounts)

(Unaudited)

	Three Months Ended March 31,	
	2016	2015
Revenues		
Revenue from receivable portfolios, net	\$270,094	\$264,110
Other revenues	18,923	13,672
Total revenues	289,017	277,782
Operating expenses		
Salaries and employee benefits	69,642	65,552
Cost of legal collections	54,308	54,998
Other operating expenses	26,343	24,326
Collection agency commissions	10,120	10,685
General and administrative expenses	35,239	31,197
Depreciation and amortization	9,861	8,137
Total operating expenses	205,513	194,895
Income from operations	83,504	82,887
Other (expense) income		
Interest expense	(50,691)	(42,303)
Other income	7,124	2,117
Total other expense	(43,567)	(40,186)
Income before income taxes	39,937	42,701
Provision for income taxes	(10,148)	(14,614)
Income from continuing operations	29,789	28,087
(Loss) income from discontinued operations, net of tax	(3,182)	1,880
Net income	26,607	29,967
Net income attributable to noncontrolling interest	(913)	(542)
Net income attributable to Encore Capital Group, Inc. stockholders	\$25,694	\$29,425
Amounts attributable to Encore Capital Group, Inc.:		
Income from continuing operations	\$28,876	\$27,545
(Loss) income from discontinued operations, net of tax	(3,182)	1,880
Net income	\$25,694	\$29,425
Earnings (loss) per share attributable to Encore Capital Group, Inc.:		
Basic earnings (loss) per share from:		
Continuing operations	\$1.13	\$1.06
Discontinued operations	\$(0.12)	\$0.07
Net basic earnings per share	\$1.01	\$1.13
Diluted earnings (loss) per share from:		
Continuing operations	\$1.12	\$1.01
Discontinued operations	\$(0.13)	\$0.07
Net diluted earnings per share	\$0.99	\$1.08
Weighted average shares outstanding:		
Basic	25,550	26,072
Diluted	25,868	27,315

See accompanying notes to condensed consolidated financial statements

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ENCORE CAPITAL GROUP, INC.

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

	Three Months Ended March 31,	
	2016	2015
Net income	\$26,607	\$29,967
Other comprehensive income, net of tax:		
Change in unrealized gains/losses on derivative instruments:		
Unrealized gain on derivative instruments	66	860
Income tax effect	(26)	(347)
Unrealized gain on derivative instruments, net of tax	40	513
Change in foreign currency translation:		
Unrealized loss on foreign currency translation	(11,899)	(21,032)
Income tax effect	1,321	(1,617)
Unrealized loss on foreign currency translation, net of tax	(10,578)	(22,649)
Other comprehensive loss, net of tax	(10,538)	(22,136)
Comprehensive income	16,069	7,831
Comprehensive (income) loss attributable to noncontrolling interest:		
Net income	(913)	(542)
Unrealized loss on foreign currency translation	338	1,582
Comprehensive (income) loss attributable to noncontrolling interest	(575)	1,040
Comprehensive income attributable to Encore Capital Group, Inc. stockholders	\$15,494	\$8,871
See accompanying notes to condensed consolidated financial statements		

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

	Three Months Ended March 31,	
	2016	2015
Operating activities:		
Net income	\$26,607	\$29,967
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss (income) from discontinued operations, net of income taxes	1,352	(1,880)
Depreciation and amortization	9,861	8,137
Non-cash interest expense, net	9,533	7,805
Stock-based compensation expense	3,718	5,905
Gain on derivative instruments	(5,399)	—
Deferred income taxes	(21,588)	(4,276)
Excess tax benefit from stock-based payment arrangements	—	(637)
Loss on sale of discontinued operations, net of tax	1,830	—
Reversal of allowances on receivable portfolios, net	(2,191)	(2,859)
Changes in operating assets and liabilities		
Deferred court costs and other assets	1,233	(11,873)
Prepaid income tax and income taxes payable	18,824	4,847
Accounts payable, accrued liabilities and other liabilities	(14,023)	(15,081)
Net cash provided by operating activities from continuing operations	29,757	20,055
Net cash provided by (used in) operating activities from discontinued operations	2,096	(665)
Net cash provided by operating activities	31,853	19,390
Investing activities:		
Cash paid for acquisitions, net of cash acquired	(675)	—
Proceeds from divestiture of business, net of cash divested	106,041	—
Purchases of receivable portfolios, net of put-backs	(280,990)	(143,239)
Collections applied to investment in receivable portfolios, net	180,796	164,217
Purchases of property and equipment	(2,252)	(4,271)
Other, net	1,191	(251)
Net cash provided by investing activities from continuing operations	4,111	16,456
Net cash provided by (used in) used in investing activities from discontinued operations	14,685	(11,965)
Net cash provided by investing activities	18,796	4,491
Financing activities:		
Payment of loan costs	(1,395)	(4,279)
Proceeds from credit facilities	185,883	134,285
Repayment of credit facilities	(235,151)	(124,395)
Repayment of senior secured notes	(3,750)	(3,750)
Repayment of securitized notes	(935)	(6,625)
Taxes paid related to net share settlement of equity awards	(3,354)	(4,554)
Excess tax benefit from stock-based payment arrangements	—	637
Other, net	(2,785)	(3,592)
Net cash used in financing activities	(61,487)	(12,273)
Net (decrease) increase in cash and cash equivalents	(10,838)	11,608
Effect of exchange rate changes on cash and cash equivalents	1,858	438
Cash and cash equivalents, beginning of period	153,593	124,163
Cash and cash equivalents, end of period	144,613	136,209

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Cash and cash equivalents of discontinued operations, end of period	—	24,183
Cash and cash equivalents of continuing operations, end of period	\$144,613	\$112,026
See accompanying notes to condensed consolidated financial statements		

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ENCORE CAPITAL GROUP, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

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

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

Financial Statement Preparation and Presentation

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

In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the Company’s consolidated financial position, results of operations, and cash flows. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2015. Operating results for interim periods are not necessarily indicative of operating results for an entire fiscal year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts and the disclosure of contingent amounts in the Company’s financial statements and the accompanying notes. Actual results could materially differ from those estimates.

Basis of Consolidation

The condensed consolidated financial statements have been prepared in conformity with GAAP, and reflect the accounts and operations of the Company and those of its subsidiaries in which the Company has a controlling financial interest. The Company also consolidates VIEs, for which it is the primary beneficiary. The primary beneficiary has both (a) the power to direct the activities of the VIE that most significantly affect the entity’s economic performance, and (b) either the obligation to absorb losses or the right to receive benefits. Refer to Note 11, “Variable Interest Entities,” for further details. All intercompany transactions and balances have been eliminated in consolidation.

Translation of Foreign Currencies

The financial statements of certain of the Company’s foreign subsidiaries are measured using their local currency as the functional currency. Assets and liabilities of foreign operations are translated into U.S. dollars using period-end exchange rates, and revenues and expenses are translated into U.S. dollars using average exchange rates in effect during each period. The resulting translation adjustments are recorded as a component of other comprehensive income or loss. Equity accounts are translated at historical rates, except for the change in retained earnings during the year which is the result of the income statement translation process. Intercompany transactio