ENCORE CAPITAL GROUP INC
Form 10-Q
November 07, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________to__________.
COMMISSION FILE NUMBER: 000-26489
ENCORE CAPITAL GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware	48-1090909
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
3111 Camino Del Rio North, Suite 103 San Diego, California	92108
(Address of principal executive offices)	(Zip code)

(877) 445 - 4581
(Registrant's telephone number, including area code)
(Not Applicable)
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the last 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨ Emerging growth company ¨
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x

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

Class	Outstanding at October 31, 2018
Common Stock, $0.01 par value	30,852,178 shares

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

	September 30, 2018	December 31, 2017
Assets		
Cash and cash equivalents	$ 204,649	$ 212,139
Investment in receivable portfolios, net	3,109,116	2,890,613
Deferred court costs, net	94,017	79,963
Property and equipment, net	96,429	76,276
Other assets	244,602	302,728
Goodwill	898,591	928,993
Total assets	$ 4,647,404	$ 4,490,712
Liabilities and Equity		
Liabilities:		
Accounts payable and accrued liabilities	$ 274,213	$ 284,774
Debt, net	3,561,467	3,446,876
Other liabilities	33,279	35,151
Total liabilities	3,868,959	3,766,801
Commitments and contingencies		
Redeemable noncontrolling interest	1,231	151,978
Equity:		
Convertible preferred stock, $.01 par value, 5,000 shares authorized, no shares issued and outstanding	—	—
Common stock, $.01 par value, 50,000 shares authorized, 30,852 shares and 25,801 shares issued and outstanding as of September 30, 2018 and December 31, 2017, respectively	309	258
Additional paid-in capital	207,985	42,646
Accumulated earnings	673,153	616,314
Accumulated other comprehensive loss	(103,394)	(77,356)
Total Encore Capital Group, Inc. stockholders' equity	778,053	581,862
Noncontrolling interest	(839)	(9,929)
Total equity	777,214	571,933
Total liabilities, redeemable equity and equity	$ 4,647,404	$ 4,490,712

The following table presents certain assets and liabilities of consolidated variable interest entities ("VIEs") included in the consolidated statements of financial condition above. Most assets in the table below include those assets that can only be used to settle obligations of consolidated VIEs. The liabilities exclude amounts where creditors or beneficial interest holders have recourse to the general credit of the Company. See Note 10, "Variable Interest Entities" for additional information on the Company's VIEs.

	September 30, 2018	December 31, 2017
Assets		
Cash and cash equivalents	$ 471	$ 88,902
Investment in receivable portfolios, net	444,503	1,342,300
Deferred court costs, net	—	26,482
Property and equipment, net	—	23,138

Other assets	8,212	122,263
Goodwill	—	724,054
Liabilities		
Accounts payable and accrued liabilities	$ 3,514	$ 151,208
Debt, net	390,690	2,014,202
Other liabilities	—	1,494

See accompanying notes to condensed consolidated financial statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues				
Revenue from receivable portfolios	$295,357	$264,024	$869,028	$777,269
Other revenues	37,388	23,111	112,809	61,763
Total revenues	332,745	287,135	981,837	839,032
Allowance reversals on receivable portfolios, net	4,029	19,564	31,472	30,525
Total revenues, adjusted by net allowances	336,774	306,699	1,013,309	869,557
Operating expenses				
Salaries and employee benefits	95,634	77,232	275,853	221,296
Cost of legal collections	50,473	48,094	155,583	149,460
Other operating expenses	30,691	25,859	103,478	76,249
Collection agency commissions	10,682	10,622	34,587	33,678
General and administrative expenses	41,893	32,500	123,163	102,750
Depreciation and amortization	9,873	8,522	31,232	25,819
Total operating expenses	239,246	202,829	723,896	609,252
Income from operations	97,528	103,870	289,413	260,305
Other (expense) income				
Interest expense	(65,094)	(52,755)	(183,092)	(152,469)
Other (expense) income	(2,539)	8,873	(4,961)	12,004
Total other expense	(67,633)	(43,882)	(188,053)	(140,465)
Income from continuing operations before income taxes	29,895	59,988	101,360	119,840
Provision for income taxes	(16,879)	(17,844)	(37,657)	(43,442)
Income from continuing operations	13,016	42,144	63,703	76,398
Loss from discontinued operations, net of tax	—	—	—	(199)
Net income	13,016	42,144	63,703	76,199
Net loss (income) attributable to noncontrolling interest	7,709	(13,950)	5,147	(5,652)
Net income attributable to Encore Capital Group, Inc. stockholders	$20,725	$28,194	$68,850	$70,547
Amounts attributable to Encore Capital Group, Inc.:				
Income from continuing operations	$20,725	$28,194	$68,850	$70,746
Loss from discontinued operations, net of tax	—	—	—	(199)
Net income	$20,725	$28,194	$68,850	$70,547
Earnings (loss) per share attributable to Encore Capital Group, Inc.:				
Basic earnings (loss) per share from:				
Continuing operations	$0.69	$1.08	$2.52	$2.73
Discontinued operations	—	—	—	(0.01)
Net basic earnings per share	$0.69	$1.08	$2.52	$2.72
Diluted earnings (loss) per share from:				
Continuing operations	$0.69	$1.05	$2.49	$2.68
Discontinued operations	—	—	—	(0.01)
Net diluted earnings per share	$0.69	$1.05	$2.49	$2.67
Weighted average shares outstanding:				

Basic	29,867	26,011	27,372	25,957
Diluted	30,121	26,736	27,663	26,406

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 September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$13,016	$42,144	$63,703	$76,199
Other comprehensive (loss) income, net of tax:				
Change in unrealized gains/losses on derivative instruments:				
Unrealized (loss) gain on derivative instruments	(1,152)	(264)	(3,306)	1,170
Income tax effect	284	103	823	(409)
Unrealized (loss) gain on derivative instruments, net of tax	(868)	(161)	(2,483)	761
Change in foreign currency translation:				
Unrealized (loss) gain on foreign currency translation	(6,919)	9,712	(23,436)	32,000
Other comprehensive (loss) income, net of tax	(7,787)	9,551	(25,919)	32,761
Comprehensive income	5,229	51,695	37,784	108,960
Comprehensive (income) loss attributable to noncontrolling interest:				
Net loss (income)	7,709	(13,950)	5,147	(5,652)
Unrealized loss (gain) on foreign currency translation	1,293	(594)	(119)	(2,003)
Comprehensive loss (income) attributable to noncontrolling interest	9,002	(14,544)	5,028	(7,655)
Comprehensive income attributable to Encore Capital Group, Inc. stockholders	$14,231	$37,151	$42,812	$101,305

See accompanying notes to condensed consolidated financial statements

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ENCORE CAPITAL GROUP, INC.
Condensed Consolidated Statement of Equity
(In Thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Earnings	Accumulated Other Comprehensive Loss	Noncontrolling Interest	Total Equity
	Shares	Par					
Balance at December 31, 2017	25,801	$ 258	$ 42,646	$ 616,314	$ (77,356)	$ (9,929)	$ 571,933
Net income (loss)	—	—	—	68,850	—	(969)	67,881
Other comprehensive (loss) gain, net of tax	—	—	—	—	(26,038)	433	(25,605)
Change in fair value of redeemable noncontrolling interest	—	—	19,430	(12,011)	—	—	7,419
Purchase of noncontrolling interest	—	—	—	—	—	9,626	9,626
Exercise of stock options and issuance of share-based awards, net of shares withheld for employee taxes	132	2	(1,934)	—	—	—	(1,932)
Issuance of common stock	4,920	49	181,138	—	—	—	181,187
Stock-based compensation	—	—	10,452	—	—	—	10,452
Issuance of exchangeable notes	—	—	14,009	—	—	—	14,009
Exchangeable notes hedge transactions	—	—	(17,785)	—	—	—	(17,785)
Net equity adjustment on Cabot Transaction	—	—	(43,097)	—	—	—	(43,097)
Other	—	—	3,126	—	—	—	3,126
Balance at September 30, 2018	30,853	$ 309	$ 207,985	$ 673,153	$ (103,394)	$ (839)	$ 777,214

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

	Nine Months Ended September 30,	
	2018	2017
Operating activities:		
Net income	$63,703	$76,199
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss from discontinued operations, net of income taxes	—	199
Depreciation and amortization	31,232	25,819
Other non-cash expense, net	30,453	24,768
Stock-based compensation expense	10,452	7,041
Loss (gain) on derivative instruments, net	10,648	(2,714)
Deferred income taxes	18,733	(5,396)
Allowance reversals on receivable portfolios, net	(31,472)	(30,525)
Other, net	(9,690)	330
Changes in operating assets and liabilities		
Deferred court costs and other assets	(19,537)	(20,094)
Prepaid income tax and income taxes payable	21,419	15,565
Accounts payable, accrued liabilities and other liabilities	(5,919)	(9,501)
Net cash provided by operating activities	120,022	81,691
Investing activities:		
Cash paid for acquisitions, net of cash acquired	—	(5,623)
Purchases of receivable portfolios, net of put-backs	(881,789)	(739,478)
Collections applied to investment in receivable portfolios, net	615,010	549,544
Purchases of property and equipment	(37,436)	(20,518)
(Payment) proceeds from derivative instruments, net	(28,656)	6,140
Other, net	6,800	2,155
Net cash used in investing activities	(326,071)	(207,780)
Financing activities:		
Payment of loan costs	(6,440)	(19,910)
Proceeds from credit facilities	766,471	928,141
Repayment of credit facilities	(465,666)	(972,453)
Proceeds from senior secured notes	—	325,000
Repayment of senior secured notes	(1,029)	(203,212)
Proceeds from issuance of convertible senior notes	172,500	150,000
Repayment of convertible senior notes	—	(60,406)
Proceeds from convertible hedge instruments	—	5,580
Proceeds from other debt	9,090	8,318
Repayment of other debt	(23,450)	(4,309)
Payment for the purchase of PECs and noncontrolling interest	(234,101)	—
Payment of direct and incremental costs relating to Cabot Transaction	(8,622)	—
Other, net	(3,826)	(1,440)
Net cash provided by financing activities	$204,927	155,309
Net (decrease) increase in cash and cash equivalents	(1,122)	29,220
Effect of exchange rate changes on cash and cash equivalents	(6,368)	9,261
Cash and cash equivalents, beginning of period	212,139	149,765
Cash and cash equivalents, end of period	$204,649	$188,246

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

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

Financial Statement Preparation and Presentation

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

In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the Company’s consolidated financial position, results of operations, and cash flows. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017. Operating results for interim periods are not necessarily indicative of operating results for an entire fiscal year.

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

Basis of Consolidation

The condensed consolidated financial statements have been prepared in conformity with GAAP and reflect the accounts and operations of the Company and those of its subsidiaries in which the Company has a controlling financial interest. The Company also consolidates variable interest entities (“VIE”s), 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 10, “Variable Interest Entities,” for further details. All intercompany transactions and balances have been eliminated in consolidation.

Translation of Foreign Currencies

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

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Reclassifications
Certain immaterial reclassifications have been made to the condensed consolidated financial statements to conform to the current year's presentation.
Change in Accounting Principle
In May 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers ("Topic 606" or "ASU 2014-09"). The objective of ASU 2014-09 is to establish a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. ASU 2014-09 supersedes most of the existing revenue recognition guidance, including industry-specific guidance. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 applies to all contracts with customers except those that are within the scope of other topics in the FASB's Accounting Standards Codification ("ASC"). Under the prior accounting standard, the Company recognized revenue when there was persuasive evidence of an arrangement, the sales price was fixed or determinable, the services had been performed and collectability was reasonably assured.
The Company's investment in receivable portfolios is outside of the scope of Topic 606 since it is accounted for in accordance with ASC 310-30. Certain of the Company's international subsidiaries earn fee-based income by providing portfolio management services to credit originators for non-performing loans. Performance obligations for this revenue stream under the new standard primarily arise from debt collection and management activities. These performance obligations are typically satisfied when services are performed, or debt is collected. Consideration is typically variable based on indeterminate volumes or collection activity. Under the new accounting standard, revenue is recognized over time as a series of single performance obligations when the Company is entitled to a percentage of collections received, since the customer simultaneously receives and consumes the benefits provided by the Company's performance of debt collection and management. The method for measuring progress towards satisfying a performance obligation is based on transaction volumes or debt collected, depending on whether the contract is based on services performed or based on commissions. Costs to fulfill a contract are expensed when incurred.
The Company adopted the requirements of Topic 606 as of January 1, 2018, utilizing the modified retrospective method of transition and elected to apply the revenue standard only to contracts that were not completed as of the adoption date. Prior periods were not restated. The cumulative effect of adopting this new standard had no impact to retained earnings. The impact of adopting Topic 606 on the Company's revenue is not material to any of the periods presented. Fee-based income is included in "Other Revenues" in the Company's consolidated statements of operations.
In August 2017, the FASB issued ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities—Derivatives and Hedging ("Topic 815" or "ASU 2017-12") which amends the hedge accounting recognition and presentation requirements in ASC 815. ASU 2017-12 improves Topic 815 by simplifying and expanding the eligible hedging strategies for financial and nonfinancial risks by more closely aligning hedge accounting with a company's risk management activities, and also simplifies its application through targeted improvements in key practice areas. This includes expanding the list of items eligible to be hedged and amending the methods used to measure the effectiveness of hedging relationships. In addition, ASU 2017-12 prescribes how hedging results should be presented and requires incremental disclosures. These changes are intended to allow preparers more flexibility and to enhance the transparency of how hedging results are presented and disclosed. Further, the new standard provides partial relief on the timing of certain aspects of hedge documentation and eliminates the requirement to recognize hedge ineffectiveness separately in earnings in the current period. For public entities, ASU 2017-12 is effective for fiscal years, including interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted in any interim period or fiscal year. The Company early adopted ASU 2017-12 as of the second quarter of 2018 retroactive to January 1, 2018. The adoption of the new standard did not have a material effect on the Company's financial position, results of operations, or required presentations.
Recent Accounting Pronouncements
Other than the adoption of the standards discussed above, there have been no new accounting pronouncements made effective during the three and nine months ended September 30, 2018 that have significance, or potential significance, to the Company's consolidated financial statements.

Recent Accounting Pronouncements Not Yet Effective
In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350). The amendments in this update simplify the test for goodwill impairment by eliminating Step 2 from the impairment test, which required the entity to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities following the procedure

that would be required in determining fair value of assets acquired and liabilities assumed in a business combination. The amendments in this update are effective for public companies for annual or any interim goodwill impairments tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company did not early adopt this guidance for its annual goodwill impairment testing and does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

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

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 changes accounting for leases and requires lessees to recognize the assets and liabilities arising from most leases, including those classified as operating leases under previous accounting guidance, on the balance sheet and requires disclosure of key information about leasing arrangements to increase transparency and comparability among organizations. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, which provides narrow amendments to clarify how to apply certain aspects of the new lease standard. In July 2018, ASU 2018-11, Leases: Targeted Improvements, was issued to provide relief to companies from restating comparative periods. Pursuant to ASU 2018-11, in the period of adoption, the Company will not restate comparative periods presented in its financial statements. The new guidance will be effective for the Company starting in the first quarter of fiscal year 2019. Early adoption is permitted; however, the Company does not intend to early adopt. The Company is developing an inventory of all leases, accumulating the lease data necessary to apply the amended guidance and is in the process of determining the effects the adoption will have on its consolidated financial statements, systems and processes. The Company has selected a software to assist with implementation to the standard.

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

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Note 2: Earnings Per Share

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Weighted average common shares outstanding—basic	29,867	26,011	27,372	25,957
Dilutive effect of stock-based awards	254	271	291	214
Dilutive effect of convertible senior notes	—	454	—	235
Weighted average common shares outstanding—diluted	30,121	26,736	27,663	26,406

Anti-dilutive employee stock options outstanding were approximately 13,000 during each of the three and nine months ended September 30, 2018. Anti-dilutive employee stock options outstanding were approximately 13,000 and 138,000 during the three and nine months ended September 30, 2017, respectively.

Note 3: Cabot Transaction

On July 24, 2018, the Company completed the purchase of all the outstanding interests of Cabot not owned by the Company (the "Cabot Transaction"). As a result, Cabot became a wholly owned subsidiary of Encore. The acquisition of the remaining interest was accounted for as an equity transaction and no gain or loss was recognized in the Company's consolidated statements of operations but was reflected as a component of additional paid-in capital in the consolidated statement of equity. Additionally, in accordance with authoritative guidance and the Company's policy, the direct and incremental costs associated with the Cabot Transaction were accounted for as part of the equity transaction. Total consideration transferred was approximately $414.7 million, which consisted of cash of $234.1 million and the equivalent of $180.6 million of Encore common stock based on the last reported sale price of Encore common stock per share of $36.80 on July 24, 2018.

	(in thousands)
Cash consideration	$ 234,101
Stock consideration	180,559
Total consideration transferred	414,660
Less: Preferred equity certificates acquired	(262,512)
Consideration transferred to acquire remaining equity interest	152,148
Less: Carrying value of redeemable noncontrolling interest	(127,299)
Less: Carrying value of noncontrolling interest	9,626
Net loss directly recorded in equity	34,475
Direct and incremental transaction costs	8,622
Total reduction in additional paid-in capital	$ 43,097

Note 4: Fair Value Measurements

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

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- Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs, including inputs that reflect the reporting entity's own assumptions.

Financial Instruments Required To Be Carried At Fair Value

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

	Fair Value Measurements as of September 30, 2018			
	Level 1	Level 2	Level 3	Total
Assets				
Interest rate swap agreements	$ —	$ 5	$ —	$ 5
Interest rate cap contracts	—	2,445	—	2,445
Liabilities				
Foreign currency exchange contracts	—	(1,408)	—	(1,408)
Contingent consideration	—	—	(7,417)	(7,417)
Temporary Equity				
Redeemable noncontrolling interest	—	—	(1,231)	(1,231)

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

Derivative Contracts:

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

Contingent Consideration:

The Company carries certain contingent liabilities resulting from its mergers and acquisition activities. Certain sellers of the Company's acquired entities could earn additional earn-out payments in cash based on the entities' subsequent operating performance. The Company recorded the acquisition date fair values of these contingent liabilities, based on the likelihood of contingent earn-out payments, as part of the consideration transferred. The earn-out payments are subsequently remeasured to fair value at each reporting date. The Company reviewed the earn-out analysis during the three and nine months ended September 30, 2018 and determined that, based on actual and forecasted operating performance, the expected future earn-out payments would remain the same and be reduced by approximately $4.7 million, respectively. As of September 30, 2018, the aggregated fair value of the contingent consideration was approximately $7.4 million.

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The following table provides a roll forward of the fair value of contingent consideration for the periods ended September 30, 2018 and December 31, 2017 (in thousands):

	Amount
Balance at December 31, 2016	$2,531
Issuance of contingent consideration in connection with acquisition	10,808
Change in fair value of contingent consideration	(2,465)
Payment of contingent consideration	(781)
Effect of foreign currency translation	519
Balance at December 31, 2017	10,612
Issuance of contingent consideration in connection with acquisition	1,728
Change in fair value of contingent consideration	(4,652)
Payment of contingent consideration	(232)
Effect of foreign currency translation	(39)
Balance at September 30, 2018	$7,417

Redeemable Noncontrolling Interest:

Some minority shareholders in certain subsidiaries of the Company have the right, at certain times, to require the Company to acquire their ownership interest in those entities at fair value and, in some cases, to force a sale of the subsidiary if the Company chooses not to purchase their interests at fair value. The noncontrolling interest subject to this arrangement is included in temporary equity as redeemable noncontrolling interest and is adjusted to its estimated redemption amount each reporting period. Future reductions in the carrying amount are subject to a “floor” amount that is equal to the fair value of the redeemable noncontrolling interest at the time it was originally recorded. The recorded value of the redeemable noncontrolling interest cannot go below the floor level. Adjustments to the carrying amount of redeemable noncontrolling interest are charged to retained earnings (or to additional paid-in capital if there are no retained earnings) and do not affect net income or comprehensive income in the consolidated financial statements.

On July 24, 2018, in connection with the Cabot Transaction, the Company purchased the outstanding redeemable noncontrolling interest held by Cabot’s previous minority shareholders for approximately $127.3 million.

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

	Amount
Balance at December 31, 2016	$45,755
Addition to redeemable noncontrolling interest	277
Net loss attributable to redeemable noncontrolling interest	(4,905)
Adjustment of the redeemable noncontrolling interest to fair value	108,296
Effect of foreign currency translation attributable to redeemable noncontrolling interest	2,555
Balance at December 31, 2017	151,978
Redemption of redeemable noncontrolling interest	(138,835)
Net loss attributable to redeemable noncontrolling interest	(4,178)
Adjustment of the redeemable noncontrolling interest to fair value	(7,419)
Effect of foreign currency translation attributable to redeemable noncontrolling interest	(315)
Balance at September 30, 2018	$1,231

Non-Recurring Fair Value Measurement:

Certain assets are measured at fair value on a nonrecurring basis. These assets include real estate-owned assets classified as held for sale at the lower of their carrying value or fair value less cost to sell. The fair value of the assets held for sale and estimated selling expenses were determined using Level 2 measurements. The fair value estimate of the assets held for sale was approximately $26.2 million and $18.7 million as of September 30, 2018 and December 31, 2017, respectively.

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Financial Instruments Not Required To Be Carried At Fair Value
Investment in Receivable Portfolios:
The Company records its investment in receivable portfolios at cost, which represents a significant discount from the contractual receivable balances due. The Company computes the fair value of its investment in receivable portfolios using Level 3 inputs by discounting the estimated future cash flows generated by its proprietary forecasting models. The key inputs include the estimated future gross cash flow, average cost to collect, and discount rate. In accordance with authoritative guidance related to fair value measurements, the Company estimates the average cost to collect and discount rates based on its estimate of what a market participant might use in valuing these portfolios. The determination of such inputs requires significant judgment, including assessing the assumed market participant's cost structure, its determination of whether to include fixed costs in its valuation, its collection strategies, and determining the appropriate weighted average cost of capital. The Company evaluates the use of these key inputs on an ongoing basis and refines the data as it continues to obtain better information from market participants in the debt recovery and purchasing business.
In the Company's current analysis, the fair value of investment in receivable portfolios was approximately $3,041.9 million and $3,415.3 million as of September 30, 2018 and December 31, 2017, respectively, as compared to the carrying value of $3,109.1 million and $2,890.6 million as of September 30, 2018 and December 31, 2017, respectively. A 100 basis point increase in the cost to collect and discount rate used would result in a decrease in the fair value of U.S. and European portfolios by approximately $56.5 million and $76.5 million, respectively, as of September 30, 2018. This fair value calculation does not represent, and should not be construed to represent, the underlying value of the Company or the amount which could be realized if its investment in receivable portfolios were sold.
Deferred Court Costs:
The Company capitalizes deferred court costs and provides a reserve for those costs that it believes will ultimately be uncollectible. The carrying value of net deferred court costs approximates fair value.
Debt:
The majority of the Company's borrowings are carried at historical amounts, adjusted for additional borrowings less principal repayments, which approximate fair value. These borrowings include Encore's senior secured notes and borrowings under its revolving credit and term loan facilities, and Cabot's borrowings under its revolving credit facility.
Encore's convertible notes and exchangeable notes are carried at historical cost, adjusted for the debt discount. The carrying value of the convertible notes and exchangeable notes was $616.6 million and $450.8 million, net of the debt discount of $39.4 million and $32.7 million as of September 30, 2018 and December 31, 2017, respectively. The fair value estimate for these convertible notes and exchangeable notes, which incorporates quoted market prices using Level 2 inputs, was approximately $650.4 million and $520.9 million as of September 30, 2018 and December 31, 2017, respectively.
Cabot's senior secured notes are carried at historical cost, adjusted for the debt discount and debt premium. The carrying value of Cabot's senior secured notes was $1,218.8 million and $1,214.6 million, net of the debt discount of $1.7 million and $1.9 million as of September 30, 2018 and December 31, 2017, respectively. The fair value estimate for these senior notes, which incorporates quoted market prices using Level 2 inputs, was $1,207.1 million and $1,258.9 million as of September 30, 2018 and December 31, 2017, respectively.
Note 5: Derivatives and Hedging Instruments
The Company may periodically enter into derivative financial instruments to manage risks related to interest rates and foreign currency. Certain of the Company's derivative financial instruments qualify for hedge accounting treatment under the authoritative guidance for derivatives and hedging.
During the second quarter of 2018, the Company early adopted ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities retroactive to January 1, 2018 with no material impact to its financial statements. Periods prior to January 1, 2018 have not been restated. The Company applies hedge accounting when derivatives are designated, qualified and highly effective as hedges. Effectiveness is formally assessed and documented at inception and each period throughout the life of a hedge using various qualitative or quantitative methods appropriate for each

hedge. Under hedge accounting, the changes in fair value of the derivative and the hedged risk are generally recognized together and offset each other when reported in shareholders' net income. Changes in the fair value of a derivative instrument may not always equal changes in the fair value of the hedged item. This is referred to as "hedge ineffectiveness" and, with the adoption of ASU 2017-12, is no longer measured and reported separately from the effective portion of the hedge. The Company excludes certain components of derivative instruments' changes in fair value from the assessment of hedge effectiveness. With the adoption of ASU 2017-12, those

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excluded components are initially recorded in other comprehensive income and recognized in shareholders' net income over the life of the derivative instrument. The Company did not record a cumulative-effect adjustment on January 1, 2018 (that would have impacted retained earnings and accumulated other comprehensive income by the same amount upon adoption) because there was no ineffectiveness recognized for hedges existing at that date.

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

	September 30, 2018		December 31, 2017	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:				
Foreign currency exchange contracts	Other assets	$ —	Other assets	$ 1,912
Foreign currency exchange contracts	Other liabilities	(1,408)	Other liabilities	—
Interest rate swap agreements	Other assets	5	Other liabilities	(7)
Derivatives not designated as hedging instruments:				
Foreign currency exchange contracts	Other liabilities	—	Other liabilities	(1,110)
Interest rate cap contracts	Other assets	2,445	Other assets	3,922

Derivatives Designated as Hedging Instruments

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

Certain of the foreign currency forward contracts are designated as cash flow hedging instruments and qualify for hedge accounting treatment. Gains and losses arising from such contracts are recorded as a component of accumulated other comprehensive income ("OCI") as gains and losses on derivative instruments, net of income taxes. The hedging gains and losses in OCI are subsequently reclassified into earnings in the same period in which the underlying transactions affect the Company's earnings. If all or a portion of the forecasted transaction is cancelled, the Company would reclassify the hedge into earnings.

As of September 30, 2018, the total notional amount of the forward contracts that are designated as cash flow hedging instruments was $19.2 million. All of these outstanding contracts qualified for hedge accounting treatment. The Company estimates that approximately $1.4 million of net derivative loss included in OCI will be reclassified into earnings within the next 12 months. No gains or losses were reclassified from OCI into earnings as a result of forecasted transactions that failed to occur during the nine months ended September 30, 2018 and 2017.

The Company may periodically enter into interest rate swap agreements to reduce its exposure to fluctuations in interest rates on variable interest rate debt and their impact on earnings and cash flows. As of September 30, 2018, there were two interest rate swap agreements outstanding with a total notional amount of $30.0 million Australian dollars (approximately $21.7 million U.S. dollars). The interest rate swap agreements are designated as cash flow hedges and accounted for using hedge accounting.

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

Derivatives Designated as Hedging Instruments	Gain or (Loss) Recognized in OCI Three Months Ended September 30, 2018	2017	Location of Gain or (Loss) Reclassified from OCI into Income	Gain or (Loss) Reclassified from OCI into Income Three Months Ended September 30, 2018	2017
Foreign currency exchange contracts	$ (916)	$ (27)	Salaries and employee benefits	$ 95	$ 286
Foreign currency exchange contracts	(130)	70	General and administrative expenses	11	35
Interest rate swap agreements	3	10	Interest expense	4	—

Derivatives Designated as Hedging Instruments	Gain or (Loss) Recognized in OCI Nine Months Ended September 30, 2018	2017	Location of Gain or (Loss) Reclassified from OCI into Income	Gain or (Loss) Reclassified from OCI into Income Nine Months Ended September 30, 2018	2017
Foreign currency exchange contracts	$ (1,990)	$ 1,708	Salaries and employee benefits	$ 1,078	$ 758
Foreign currency exchange contracts	(206)	310	General and administrative expenses	46	76
Interest rate swap agreements	(9)	29	Interest expense	29	110

In October 2018, the Company entered into four separate interest rate swap agreements in an aggregated notional amount of $349.5 million to hedge the exposure to fluctuations in interest rates on its variable interest rate debt. Under the swap agreements, the Company receives floating interest rate payments and makes interest payments based on fixed interest rates. In accordance with authoritative guidance relating to derivatives and hedging transactions, the Company designates its interest rate swap instruments as cash flow hedges.

In October 2018, the Company, through its wholly owned subsidiary Cabot, entered into an interest rate cap contract (the "2018 Cap") with a notional amount of £300.0 million (approximately $390.6 million) that is used to manage its risk related to interest rate fluctuations on Cabot's variable interest rate bearing debt. The 2018 Cap matures in September 2021 and is structured as a series of European call options ("Caplets") such that if exercised, Cabot will receive a payment equal to 3-months GBP-LIBOR on a notional amount equal to the hedged notional amount net of a fixed strike price. Each interest rate reset date, Cabot will elect to exercise the Caplet or let it expire. The potential cash flows from each Caplet are expected to offset any variability in the cash flows of the interest payments to the extent GBP-LIBOR exceeds the strike price of the Caplets. The Company expects the hedge relationship to be highly effective and designates the 2018 Cap as a cash flow hedge instrument.

Derivatives Not Designated as Hedging Instruments

On May 8, 2018, in anticipation of the completion of the Cabot Transaction, Encore entered into a foreign exchange forward contract with a notional amount of £176.0 million, which was approximately the amount of cash consideration for the Cabot Transaction. The forward contract settled on August 3, 2018 at a total loss of $9.3 million. This loss was substantially offset by a decrease in the final purchase price in U.S. dollars for the Cabot Transaction.

The Company enters into currency exchange forward contracts to reduce the effects of currency exchange rate fluctuations between the British Pound and Euro. These derivative contracts generally mature within one to three months and are not designated as hedge instruments for accounting purposes. The Company continues to monitor the level of exposure of the foreign currency exchange risk and may enter into additional short-term forward contracts on an ongoing basis. The gains or losses on these derivative contracts are recognized in other income or expense based on the changes in fair value.

As of September 30, 2018, the Company, through its wholly owned subsidiary Cabot, also held two interest rate cap contracts with an aggregate notional amount of £300.0 million (approximately $390.7 million) that were used to manage its risk related to interest rate fluctuations. The Company did not apply hedge accounting on these interest rate cap contracts. In October 2018, Cabot terminated these interest rate cap contracts and entered into a new 2018 Cap as discussed above.

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

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative			
		Three Months Ended September 30,		Nine Months Ended September 30,	
		2018	2017	2018	2017
Foreign currency exchange contracts	Other (expense) income	$(2,281)	$(833)	$(9,221)	$1,790
Interest rate cap contracts	Interest income (expense)	289	919	(1,427)	919
Interest rate swap agreements	Interest expense	—	—	—	110

Note 6: Investment in Receivable Portfolios, Net

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

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

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

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

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

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

	Accretable Yield	Estimate of Zero Basis Cash Flows	Total
Balance at December 31, 2017	$3,695,069	$369,632	$4,064,701
Revenue from receivable portfolios	(249,821)	(31,188)	(281,009)
Allowance reversals on receivable portfolios, net	(8,082)	(1,729)	(9,811)
Reductions on existing portfolios, net	(24,945)	(39,529)	(64,474)
Additions for current purchases	285,172	—	285,172
Effect of foreign currency translation	57,577	643	58,220
Balance at March 31, 2018	3,754,970	297,829	4,052,799
Revenue from receivable portfolios	(258,698)	(33,964)	(292,662)
Allowance reversals on receivable portfolios, net	(15,411)	(2,221)	(17,632)
Additions on existing portfolios, net	136,267	5,824	142,091
Additions for current purchases	345,006	—	345,006
Effect of foreign currency translation	(97,448)	(597)	(98,045)
Balance at June 30, 2018	3,864,686	266,871	4,131,557
Revenue from receivable portfolios	(263,109)	(32,248)	(295,357)
Allowance reversals on receivable portfolios, net	(1,196)	(2,833)	(4,029)
Additions on existing portfolios, net	23,241	14,481	37,722
Additions for current purchases	262,751	—	262,751
Effect of foreign currency translation	(20,483)	(136)	(20,619)
Balance at September 30, 2018	$3,865,890	$246,135	$4,112,025

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	Accretable Yield	Estimate of Zero Basis Cash Flows	Total
Balance at December 31, 2016	$3,092,004	$365,504	$3,457,508
Revenue from receivable portfolios	(211,105)	(38,733)	(249,838)
Allowance reversals on receivable portfolios, net	(613)	(1,519)	(2,132)
(Reductions) additions on existing portfolios, net	(90,138)	57,446	(32,692)
Additions for current purchases	200,728	—	200,728
Effect of foreign currency translation	38,712	467	39,179
Balance at March 31, 2017	3,029,588	383,165	3,412,753
Revenue from receivable portfolios	(224,310)	(39,097)	(263,407)
Allowance reversals on receivable portfolios, net	(7,121)	(1,708)	(8,829)
Additions on existing portfolios, net	225,021	9,888	234,909
Additions for current purchases	258,687	—	258,687
Effect of foreign currency translation	66,927	(753)	66,174
Balance at June 30, 2017	3,348,792	351,495	3,700,287
Revenue from receivable portfolios	(230,403)	(33,621)	(264,024)
Allowance reversals on receivable portfolios, net	(17,817)	(1,747)	(19,564)
Additions on existing portfolios, net	27,162	1,539	28,701
Additions for current purchases	336,725	—	336,725
Effect of foreign currency translation	56,971	375	57,346
Balance at September 30, 2017	$3,521,430	$318,041	$3,839,471

During the three months ended September 30, 2018, the Company purchased receivable portfolios with a face value of $1.6 billion for $248.7 million, or a purchase cost of 15.9% of face value. The estimated future collections at acquisition for all portfolios purchased during the three months ended September 30, 2018 amounted to $512.3 million. During the three months ended September 30, 2017, the Company purchased receivable portfolios with a face value of $3.0 billion for $292.3 million, or a purchase cost of 9.7% of face value. The estimated future collections at acquisition for all portfolios purchased during the three months ended September 30, 2017 amounted to $630.6 million.

During the nine months ended September 30, 2018, the Company purchased receivable portfolios with a face value of $6.2 billion for $885.0 million, or a purchase cost of 14.2% of face value. The estimated future collections at acquisition for all portfolios purchased during the nine months ended September 30, 2018 amounted to $1,772.9 million. During the nine months ended September 30, 2017, the Company purchased receivable portfolios with a face value of $7.1 billion for $757.5 million, or a purchase cost of 10.6% of face value. The estimated future collections at acquisition for all portfolios purchased during the nine months ended September 30, 2017 amounted to $1,555.0 million.

All collections realized after the net book value of a portfolio has been fully recovered (“Zero Basis Portfolios”) are recorded as revenue (“Zero Basis Revenue”). During the three months ended September 30, 2018 and 2017, Zero Basis Revenue was approximately $32.2 million and $33.6 million, respectively. During the three months ended September 30, 2018 and 2017, allowance reversals on Zero Basis Portfolios were $2.8 million and $1.7 million, respectively.

During the nine months ended September 30, 2018 and 2017, Zero Basis Revenue was approximately $97.4 million and $111.5 million, respectively. During the nine months ended September 30, 2018 and 2017, allowance reversals on Zero Basis Portfolios were $6.8 million and $5.0 million, respectively.

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

	Three Months Ended September 30, 2018			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	$3,074,292	$ 10,329	$ —	$3,084,621
Purchases of receivable portfolios	248,691	—	—	248,691
Disposals or transfers to assets held for sale	(4,253)	(1,111)	—	(5,364)
Gross collections[1]	(463,474)	(306)	(35,063)	(498,843)
Put-Backs and Recalls[2]	(2,056)	—	(18)	(2,074)
Foreign currency adjustments	(17,208)	(93)	—	(17,301)
Revenue recognized	263,109	—	32,248	295,357
Portfolio allowance reversals, net	1,196	—	2,833	4,029
Balance, end of period	$3,100,297	$ 8,819	$ —	$3,109,116
Revenue as a percentage of collections[3]	56.8 %	— %	92.0 %	59.2 %

	Three Months Ended September 30, 2017			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	$2,541,590	$ 14,335	$ —	$2,555,925
Purchases of receivable portfolios	292,332	—	—	292,332
Disposals or transfers to assets held for sale	(3,536)	(265)	—	(3,801)
Gross collections[1]	(407,435)	(435)	(35,126)	(442,996)
Put-Backs and Recalls[2]	(407)	—	(242)	(649)
Foreign currency adjustments	44,366	46	—	44,412
Revenue recognized	230,403	—	33,621	264,024
Portfolio allowance reversals, net	17,817	—	1,747	19,564
Balance, end of period	$2,715,130	$ 13,681	$ —	$2,728,811
Revenue as a percentage of collections[3]	56.5 %	— %	95.7 %	59.6 %

(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 portfolio allowances or net portfolio allowance reversals.

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	Nine Months Ended September 30, 2018			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	$2,879,170	$ 11,443	$ —	$2,890,613
Purchases of receivable portfolios	885,033	—	—	885,033
Disposals or transfers to assets held for sale	(9,358)	(1,373)	—	(10,731)
Gross collections[1]	(1,379,095)	(1,729)	(103,214)	(1,484,038)
Put-Backs and Recalls[2]	(14,231)	—	(171)	(14,402)
Foreign currency adjustments	(57,539)	(320)	—	(57,859)
Revenue recognized	771,628	—	97,400	869,028
Reclassification adjustments[3]	—	798	(798)	—
Portfolio allowance reversals, net	24,689	—	6,783	31,472
Balance, end of period	$3,100,297	$ 8,819	$ —	$3,109,116
Revenue as a percentage of collections[4]	56.0 %	— %	94.4 %	58.6 %

	Nine Months Ended September 30, 2017			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	$2,368,366	$ 14,443	$ —	$2,382,809
Purchases of receivable portfolios	756,305	1,169	—	757,474
Disposals or transfers to assets held for sale	(11,004)	(265)	—	(11,269)
Gross collections[1]	(1,212,357)	(1,534)	(116,150)	(1,330,041)
Put-Backs and Recalls[2]	(5,401)	—	(275)	(5,676)
Foreign currency adjustments	127,852	(132)	—	127,720
Revenue recognized	665,818	—	111,451	777,269
Portfolio allowance reversals, net	25,551	—	4,974	30,525
Balance, end of period	$2,715,130	$ 13,681	$ —	$2,728,811
Revenue as a percentage of collections[4]	54.9 %	— %	96.0 %	58.4 %

(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. Recalls represent accounts that are recalled by the seller in accordance with the respective purchase agreement.

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

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

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

	Valuation Allowance			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Balance at beginning of period	$75,129	$130,675	$102,576	$137,037
Provision for portfolio allowances	6,156	10,181	8,816	10,863
Reversal of prior allowances	(10,185)	(29,745)	(40,288)	(41,388)
Effect of foreign currency translation	(365)	1,759	(369)	6,358
Balance at end of period	$70,735	$112,870	$70,735	$112,870

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Note 7: Deferred Court Costs, Net

The Company pursues legal collections using a network of attorneys that specialize in collection matters and through its internal legal channel. The Company generally pursues collections through legal means only when it believes a consumer has sufficient assets to repay their indebtedness but has, to date, been unwilling to pay. In order to pursue legal collections the Company is required to pay certain upfront costs to the applicable courts that are recoverable from the consumer ("Deferred Court Costs").

The Company capitalizes Deferred Court Costs in its consolidated financial statements and provides a reserve for those costs that it believes will ultimately be uncollectible. The Company determines the reserve based on an estimated court cost recovery rate established based on its analysis of historical court costs recovery data. The Company estimates deferral periods for Deferred Court Costs based on jurisdiction and nature of litigation and writes off any Deferred Court Costs not recovered within the respective deferral period. Collections received from debtors are first applied against related court costs with the balance applied to the debtors' account balance.

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

	September 30, 2018	December 31, 2017
Court costs advanced	$ 812,359	$ 743,584
Court costs recovered	(328,715)	(299,606)
Court costs reserve	(389,627)	(364,015)
Deferred court costs	$ 94,017	$ 79,963

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

	Court Cost Reserve			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Balance at beginning of period	$(381,125)	$(345,971)	$(364,015)	$(327,926)
Provision for court costs	(23,065)	(19,767)	(67,293)	(60,031)
Net down of reserve after deferral period	13,603	12,419	38,990	36,992
Effect of foreign currency translation	960	(1,491)	2,691	(3,845)
Balance at end of period	$(389,627)	$(354,810)	$(389,627)	$(354,810)

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Note 8: Other Assets

Other assets consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Identifiable intangible assets, net	$ 64,067	$ 75,736
Other financial receivables	41,003	37,861
Service fee receivables	31,782	25,609
Assets held for sale	26,241	18,741
Prepaid expenses	24,341	27,606
Deferred tax assets	14,376	18,773
Security deposits	2,947	3,451
Derivative instruments	2,450	5,834
Funds held in escrow	—	28,199
Prepaid income taxes	—	27,917
Other	37,395	33,001
Total	$ 244,602	$ 302,728

Note 9: Debt, Net

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

	September 30, 2018	December 31, 2017
Encore revolving credit facility	$ 447,000	$ 328,961
Encore term loan facility	197,927	181,687
Encore senior secured notes	325,000	326,029
Encore convertible notes and exchangeable notes	656,000	483,500
Less: debt discount	(39,445)	(32,720)
Cabot senior secured notes	1,220,524	1,216,485
Less: debt discount	(1,734)	(1,927)
Cabot senior revolving credit facility	283,678	179,008
Cabot securitisation senior facility	390,690	391,790
Preferred equity certificates	—	253,324
Other credit facilities	57,980	68,001
Other	63,633	92,792
Capital lease obligations	8,005	6,069
	3,609,258	3,492,999
Less: debt issuance costs, net of amortization	(47,791)	(46,123)
Total	$ 3,561,467	$ 3,446,876

Encore Revolving Credit Facility and Term Loan Facility

The Company has a revolving credit facility and term loan facility pursuant to a Third Amended and Restated Credit Agreement dated December 20, 2016 (as amended, the "Restated Credit Agreement"). The Restated Credit Agreement includes a revolving credit facility of $894.4 million (the "Revolving Credit Facility") and a term loan facility of $203.7 million (the "Term Loan Facility", and together with the Revolving Credit Facility, the "Senior Secured Credit Facilities").

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During the quarter, the Company (1) extended the maturity of approximately $107.4 million of Revolving Credit Facility commitments from February 2019 to December 2021 and (2) exercised the remaining $99.7 million remaining on the accordion feature. Provisions of the Restated Credit Agreement as of September 30, 2018 include, but are not limited to:

- Revolving Credit Facility commitments of (1) $884.2 million that expire in December 2021 and (2) $10.2 million that expire in February 2019, in each case with interest at a floating rate equal to, at the Company's option, either: (a) reserve adjusted London Interbank Offered Rate ("LIBOR"), plus a spread that ranges from 250 to 300 basis points depending on the cash flow leverage ratio of Encore and its restricted subsidiaries as defined in the Restated Credit Agreement; or (b) alternate base rate, plus a spread that ranges from 150 to 200 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries. "Alternate base rate," as defined in the Restated Credit Agreement, means the highest of (i) the per annum rate which the administrative agent publicly announces from time to time as its prime lending rate, (ii) the federal funds effective rate from time to time, plus 0.5% per annum, (iii) reserved adjusted LIBOR determined on a daily basis for a one month interest period, plus 1.0% per annum and (iv) zero;
- A $194.6 million term loan maturing in December 2021, with interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted LIBOR, plus a spread that ranges from 250 to 300 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries; or (2) alternate base rate, plus a spread that ranges from 150 to 200 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries. Principal amortizes $2.5 million in 2018 and $15.3 million in each of 2019 and 2020 with the remaining principal due in 2021;
- A $9.1 million term loan maturing in February 2019, with interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted LIBOR, plus a spread that ranges from 250 to 300 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries; or (2) alternate base rate, plus a spread that ranges from 150 to 200 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries. Principal amortizes $0.3 million in 2018 with the remaining principal due in 2019;
- A borrowing base under the Revolving Credit Facility equal to 35% of all eligible non-bankruptcy estimated remaining collections plus 55% of eligible estimated remaining collections for consumer receivables subject to bankruptcy;
- A maximum cash flow leverage ratio permitted of 3.00:1.00;
- A maximum cash flow first-lien leverage ratio of 2.00:1.00;
- A minimum interest coverage ratio of 1.75:1.00;
- The allowance of indebtedness in the form of senior secured notes not to exceed $350.0 million;
- The allowance of additional unsecured or subordinated indebtedness not to exceed $1.1 billion, including junior lien indebtedness not to exceed $400.0 million;
- Restrictions and covenants, which limit the payment of dividends and the incurrence of additional indebtedness and liens, among other limitations;
- Repurchases of up to $150.0 million of Encore's common stock after July 9, 2015, subject to compliance with certain covenants and available borrowing capacity;
- A change of control definition, that excludes acquisitions of stock by Red Mountain Capital Partners LLC, JCF FPK I, LP and their respective affiliates of up to 50% of the outstanding shares of Encore's voting stock;
- Events of default which, upon occurrence, may permit the lenders to terminate the facility and declare all amounts outstanding to be immediately due and payable;
- A pre-approved acquisition limit of $225.0 million per fiscal year;
- A basket to allow for investments not to exceed the greater of (1) 200% of the consolidated net worth of Encore and its restricted subsidiaries; and (2) an unlimited amount such that after giving effect to the making of any investment, the cash flow leverage ratio is less than 1.25:1:00;
- A basket to allow for investments in persons organized under the laws of Canada in the amount of $50.0 million;

- A requirement that Encore and its restricted subsidiaries, for the four-month period ending February 2019, have sufficient cash or availability under the Revolving Credit Facility (excluding availability under revolving commitments expiring in February 2019) to satisfy any amounts due under the revolving commitments that expire in February 2019 and the sub-tranche of the Term Loan Facility that expires in February 2019;
- Collateralization by all assets of the Company, other than the assets of certain foreign subsidiaries and all unrestricted subsidiaries as defined in the Restated Credit Agreement.

At September 30, 2018, the outstanding balance under the Revolving Credit Facility was $447.0 million, which bore a weighted average interest rate of 5.09% and 4.32% for the three months ended September 30, 2018 and 2017, respectively, and 4.90% and 3.99% for the nine months ended September 30, 2018 and 2017, respectively. Available capacity under the Revolving Credit Facility, after taking into account borrowing base and applicable debt covenants, was $178.1 million as of September 30, 2018. At September 30, 2018, the outstanding balance under the Term Loan Facility was $197.9 million.

Encore Senior Secured Notes

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

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

Encore Convertible Notes and Exchangeable Notes

In June and July 2013, Encore issued $172.5 million aggregate principal amount of 3.000% 2020 Convertible Notes that mature on July 1, 2020 in private placement transactions (the "2020 Convertible Notes"). In March 2014, Encore issued $161.0 million aggregate principal amount of 2.875% 2021 Convertible Notes that mature on March 15, 2021 in private placement transactions (the "2021 Convertible Notes"). In March 2017, Encore issued $150.0 million aggregate principal amount of 3.250% 2022 Convertible Senior Notes that mature on March 15, 2022 in private placement transactions (the "2022 Convertible Notes" and together with the 2020 Convertible Notes and the 2021 Convertible Notes, the "Convertible Notes"). The interest on the Convertible Notes is payable semi-annually.

In July 2018, Encore Capital Europe Finance Limited ("Encore Finance"), a 100% owned finance subsidiary of Encore, issued $172.5 million aggregate principal amount of exchangeable senior notes due 2023 (the "Exchangeable Notes"). The Exchangeable Notes mature on September 1, 2023 and bear interest at a rate of 4.500% per year, payable semiannually in arrears on March 1 and September 1 of each year, beginning on March 1, 2019.

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

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	2020 Convertible Notes	2021 Convertible Notes	2022 Convertible Notes	2023 Exchangeable Notes
Initial conversion or exchange price	$ 45.72	$ 59.39	$ 45.57	$ 44.62
Closing stock price at date of issuance	$ 33.35	$ 47.51	$ 35.05	$ 36.45
Closing stock price date	June 24, 2013	March 5, 2014	February 27, 2017	July 20, 2018
Conversion or exchange rate (shares per $1,000 principal amount)	21.8718	16.8386	21.9467	22.4090
Conversion or exchange date	January 1, 2020	September 15, 2020	September 15, 2021	March 1, 2023

In the event of conversion or exchange, holders of the Company's Convertible Notes or Exchangeable Notes will receive cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election. The Company's current intent is to settle conversions and exchanges through combination settlement (i.e., convertible or exchangeable into cash up to the aggregate principal amount, and shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election and subject to certain restrictions contained in each of the indentures governing the Convertible Notes and Exchangeable Notes, for the remainder). As a result, and in accordance with authoritative guidance related to derivatives and hedging and earnings per share, only the conversion or exchange spread is included in the diluted earnings per share calculation, if dilutive. Under such method, the settlement of the conversion or exchange spread has a dilutive effect when, during any quarter, the average share price of the Company's common stock exceeds the initial conversion or exchange prices listed in the above table.

Authoritative guidance requires that issuers of convertible or exchangeable debt instruments which, upon conversion or exchange, 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 or nonexchangeable 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.

As discussed above, upon exchange of the Exchangeable Notes, the Company will pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election. However, the Company was required to settle solely in cash all exchanges with an exchange date occurring before September 28, 2018, the "share reservation date." As a result and in accordance with authoritative guidance, the exchange feature of the Exchangeable Notes did not qualify as an equity instrument and was bifurcated at the time of issuance. On September 28, 2018, the bifurcated derivative met the criteria for equity classification and was recorded in equity at fair value with no subsequent measurement. All issuance costs relating to the Exchangeable Notes were recorded as debt issuance costs. The debt and equity components, the issuance costs related to the equity component, the stated interest rate, and the effective interest rate for each of the Convertible Notes and Exchangeable Notes are listed below (in thousands, except percentages):

	2020 Convertible Notes	2021 Convertible Notes	2022 Convertible Notes	2023 Exchangeable Notes
Debt component	$ 140,247	$ 143,645	$ 137,266	$ 157,971
Equity component	$ 32,253	$ 17,355	$ 12,734	$ 14,009
Equity issuance cost	$ 1,106	$ 581	$ 398	$ —
Stated interest rate	3.000 %	2.875 %	3.250 %	4.500 %
Effective interest rate	6.350 %	4.700 %	5.200 %	6.500 %

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

	September 30, 2018	December 31, 2017
Liability component—principal amount	$ 656,000	$ 483,500
Unamortized debt discount	(39,445)	(32,720)
Liability component—net carrying amount	$ 616,555	$ 450,780
Equity component	$ 76,351	$ 62,696

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest expense—stated coupon rate	$3,676	$4,117	$10,969	$11,705
Interest expense—amortization of debt discount	2,518	2,473	7,410	7,374
Total interest expense—Convertible Notes and Exchangeable Notes	$6,194	$6,590	$18,379	$19,079

Hedge Transactions

In order to reduce the risk related to the potential dilution and/or the potential cash payments the Company may be required to make in the event that the market price of the Company's common stock becomes greater than the conversion or exchange prices of the Convertible Notes and the Exchangeable Notes, the Company maintains a hedge program that increases the effective conversion or exchange price for each of the 2020 Convertible Notes, 2021 Convertible Notes, and the Exchangeable Notes. The Company did not hedge the 2022 Convertible Notes.

As of September 30, 2018, all the hedge instruments related to the Convertible Notes and Exchangeable Notes have been determined to be indexed to the Company's own stock and meet the criteria for equity classification. In accordance with authoritative guidance, the Company recorded the cost of the hedge instruments as a reduction in additional paid-in capital and will not recognize subsequent changes in fair value of these financial instruments in its consolidated financial statements.

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

	2020 Convertible Notes	2021 Convertible Notes	2023 Exchangeable Notes
Cost of the hedge transaction(s)	$ 18,113	$ 19,545	$ 17,785
Initial conversion or exchange price	$ 45.72	$ 59.39	$ 44.62
Effective conversion or exchange price	$ 61.55	$ 83.14	$ 62.48

Cabot Senior Secured Notes

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

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

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On October 6, 2016, Cabot Financial issued £350.0 million (approximately $442.6 million) in aggregate principal amount of 7.500% Senior Secured Notes due 2023 (the “Cabot 2023 Notes”). Interest on the Cabot 2023 Notes is payable semi-annually, in arrears, on April 1 and October 1 of each year. The Cabot 2023 Notes were issued at a price equal to 100% of their face value.

On July 18, 2018, Cabot Financial completed an exchange offer whereby certain holders of the Cabot 2020 Notes and holders of the Cabot 2021 Notes exchanged their notes for additional Cabot 2023 Notes (the “Exchange Notes”). Pursuant to the exchange offer, Cabot Financial exchanged £32.2 million (approximately $42.4 million) in aggregate principal amount of the Cabot 2020 Notes and £95.0 million (approximately $125.2 million) in aggregate principal amount of the Cabot 2021 Notes, at a premium, for a total of £128.4 million (approximately $169.2 million) aggregate principal amount of the Exchange Notes. On July 18, 2018, Cabot Financial also issued £34.5 million (approximately $45.5 million) aggregate principal amount of 7.500% additional notes (the “Additional Notes”) at 99.0% plus accrued interest from and including April 1, 2018. Both the Exchange Notes and the Additional Notes were issued as additional notes under the indenture entered into by Cabot Financial, among others, dated October 6, 2016, governing the Cabot 2023 Notes and are part of the same series as the currently outstanding £350.0 million 7.500% Cabot 2023 Notes issued under that indenture. The fees relating to this refinancing transaction were approximately $6.6 million and were recorded as interest expense in the Company’s consolidated statements of operations during the three and nine months ended September 30, 2018.

The Cabot 2020 Notes, Cabot 2021 Notes, and the Cabot 2023 Notes (together the “Cabot Notes”) are fully and unconditionally guaranteed on a senior secured basis by the following indirect subsidiaries of the Company: Cabot Credit Management Limited (“CCM”), Cabot Financial Limited, and all material subsidiaries of Cabot Financial Limited (other than Cabot Financial and Marlin Intermediate Holdings plc). The Cabot Notes are secured by a first ranking security interest in all the outstanding shares of Cabot Financial and the guarantors (other than CCM and Marlin Midway Limited) and substantially all the assets of Cabot Financial and the guarantors (other than CCM). Subject to the Intercreditor Agreement described below under “Cabot Senior Revolving Credit Facility”, the guarantees provided in respect of the Cabot Notes are pari passu with each such guarantee given in respect of the Cabot Floating Rate Notes, Marlin Bonds and the Cabot Credit Facility described below.

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest expense—stated coupon rate	$21,411	$24,285	$64,250	$73,278
Interest income—accretion of debt premium	—	(758)	—	(2,855)
Interest expense—amortization of debt discount	117	119	120	345
Total interest expense—Cabot senior secured notes	$21,528	$23,646	$64,370	$70,768

At September 30, 2018, the outstanding balance of the Cabot senior secured notes was $1.2 billion.

Cabot Senior Revolving Credit Facility

On December 12, 2017, Cabot Financial (UK) Limited (“Cabot Financial UK”) entered into an amended and restated senior secured revolving credit facility agreement, which provides for a total committed facility of £295.0 million (as amended and restated, the “Cabot Credit Facility”). As of September 30, 2018, the Cabot Credit Facility consisted of a £245.0 million tranche that would expire in September 2021 and a £50.0 million tranche that would expire in March 2022, and included the following key provisions:

- Interest at LIBOR (or EURIBOR for any loan drawn in euro) plus 3.25% per annum, which may decrease to 2.75% upon certain specified conditions;
- A restrictive covenant that limits the loan to value ratio to 0.75 in the event that the Cabot Credit Facility is more than 20% utilized;
- A restrictive covenant that limits the super senior loan (i.e. the Cabot Credit Facility and any super priority hedging liabilities) to value ratio to 0.275 in the event that the Cabot Credit Facility is more than 20% utilized;
- Additional restrictions and covenants which limit, among other things, the payment of dividends and the incurrence of additional indebtedness and liens; and
- Events of default which, upon occurrence, may permit the lenders to terminate the Cabot Credit Facility and declare all amounts outstanding to be immediately due and payable.

The Cabot Credit Facility is unconditionally guaranteed by the following indirect subsidiaries of the Company: CCM, Cabot Financial Limited, and all material subsidiaries of Cabot Financial Limited. The Cabot Credit Facility is secured by first ranking security interests in all the outstanding shares of Cabot Financial UK and the guarantors (other than CCM) and substantially all the assets of Cabot Financial UK and the guarantors (other than CCM). Pursuant to the terms of intercreditor agreements entered into with respect to the relative positions of the Cabot Notes, the Cabot Floating Rate Notes and the Cabot Credit Facility, any liabilities in respect of obligations under the Cabot Credit Facility that are secured by assets that also secure the Cabot Notes and the Cabot Floating Rate Notes will receive priority with respect to any proceeds received upon any enforcement action over any such assets.

At September 30, 2018, the outstanding borrowings under the Cabot Credit Facility were approximately $283.7 million. The weighted average interest rate was 3.86% and 3.50% for the three months ended September 30, 2018 and 2017, respectively, and 3.78% and 3.51% for the nine months ended September 30, 2018 and 2017, respectively. Available capacity under the Cabot Credit Facility, after taking into account borrowing base and applicable debt covenants, was £77.2 million (approximately $100.5 million) as of September 30, 2018.

On November 5, 2018, Cabot Financial UK amended the Cabot Credit Facility to, among other things, increase the size of the facility by £90.0 million to £385.0 million, extend the maturity date to September 2022 (except for a £10.0 million tranche that expires in September 2021) and reduce the interest rate on the tranches that expire in September 2022 from LIBOR (or EURIBOR for any loan drawn in euro) plus 3.25% per annum to LIBOR (or EURIBOR for any loan drawn in euro) plus 3.00% per annum.

Cabot Securitisation Senior Facility

Cabot's wholly owned subsidiary Cabot Securitisation UK Ltd ("Cabot Securitisation") entered into a senior facility agreement (the "Senior Facility Agreement") for a committed amount of £300.0 million, of which £300.0 million was drawn as of September 30, 2018. The Senior Facility Agreement had an initial availability period ending in September 2020 and an initial repayment date in September 2022. On October 4, 2018, the Senior Facility Agreement was amended to mature in September 2023. The obligations of Cabot Securitisation under the Senior Facility Agreement are secured by first ranking security interests over all of Cabot Securitisation's property, assets and rights (including receivables purchased from Cabot Financial UK from time to time), the book value of which was approximately £329.6 million (approximately $429.2 million) as of September 30, 2018. Funds drawn under the Senior Facility Agreement will bear interest at a rate per annum equal to LIBOR plus a margin of 2.85%.

At September 30, 2018, the outstanding borrowings under the Cabot Securitisation Senior Facility were approximately $390.7 million. The weighted average interest rate was 3.56% and 3.10% for the three months ended September 30, 2018 and 2017, respectively, and 3.42% and 3.10% for the nine months ended September 30, 2018 and 2017, respectively.

On November 1, 2018, Cabot's wholly owned subsidiary Cabot Securitisation UK II Ltd ("Cabot Securitisation II") entered into a new non-recourse asset backed senior facility of £50.0 million, with a maturity date in September 2023. The facility is secured by first ranking security interests over all of Cabot Securitisation II's property, assets and rights. Funds drawn under this facility will bear interest at a rate per annum equal to LIBOR plus a margin of 4.075%.

Cabot Securitisation and Cabot Securitisation II are securitized financing vehicles and are VIEs for consolidation purposes. Refer to Note 10, “Variable Interest Entities,” for further details.

Preferred Equity Certificates

The Company previously held preferred equity certificates (“PECs”) as a result of its initial acquisition of Cabot in July 2013. The PECs were legal debt obligations to the noncontrolling shareholders of Cabot and they were carried at face amount, plus any accrued interest. The PECs accrued interest at 12% per annum.

On July 24, 2018, in connection with the Cabot Transaction, the Company acquired all outstanding PECs including accrued interest not owned by the Company of approximately $262.5 million. As of September 30, 2018, the Company no longer carried any PECs. The accrued interest expense on the PECs was approximately $2.0 million and $6.6 million during the three months ended September 30, 2018 and 2017, respectively, and $17.3 million and $19.2 million during the nine months ended September 30, 2018 and 2017, respectively.

Capital Lease Obligations

The Company has capital lease obligations primarily for computer equipment. As of September 30, 2018, the Company’s capital lease obligations were approximately $8.0 million. These capital lease obligations require monthly, quarterly or annual payments through 2023 and have implicit interest rates that range from zero to approximately 5.5%.

Note 10: Variable Interest Entities

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

The Company evaluates its relationships with its VIEs on an ongoing basis to ensure that it continues to be the primary beneficiary. A reconsideration event is significant if it changes the design of the entity or the entity’s equity investment at risk. Upon completion of the Cabot Transaction on July 24, 2018 and the subsequent change in organizational structure, Janus Holdings no longer qualified as a VIE and is now consolidated via the voting interest model.

As of September 30, 2018, the Company’s VIEs include certain securitized financing vehicles and other immaterial special purpose entities that were created to purchase receivable portfolios in certain geographies.

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

Note 11: Income Taxes

Income tax expense on income from continuing operations was $16.9 million and $17.8 million during the three months ended September 30, 2018 and 2017, respectively, and $37.7 million and $43.4 million during the nine months ended September 30, 2018 and 2017, respectively. The decreases in income tax expense for the three and nine months ended September 30, 2018 as compared to the corresponding periods in 2017 were primarily due to lower pretax income and the reduction of the U.S. corporate tax rate as prescribed by the U.S. Tax Cuts and Jobs Act (the “Tax Reform Act”). The decreases were partially offset by increased tax expense in the Company’s international subsidiaries due to the recording of various discrete items and certain Cabot Transaction related expenses not deductible for tax purposes.

On December 22, 2017, the Tax Reform Act was signed into law. The Tax Reform Act significantly revised the U.S. corporate income tax regime by, among other things, lowering the U.S. corporate tax rate from a top rate of 35% to a flat rate of 21% effective January 1, 2018, while also implementing elements of a territorial tax system and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries.

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

September 30, 2018, there were no changes made to the provisional amounts recognized in 2017.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Federal provision	21.0%	35.0 %	21.0 %	35.0 %
State provision	1.7 %	3.3 %	1.5 %	3.3 %
International provision (benefit)(1)	31.1%	(7.9)%	14.7 %	(2.2)%
Other	2.7 %	(0.7)%	(0.1)%	0.2 %
Effective rate	56.5%	29.7 %	37.1 %	36.3 %

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(1) During the three months ended September 30, 2018, the Company recorded certain discrete tax charges of approximately $5.0 million relating to previously established deferred tax assets in certain foreign subsidiaries in Latin America from which the Company no longer believes it will receive any benefit. In addition, the international provision increased due to nondeductible costs related to the Cabot Transaction. As a result, the effective international tax rates during the three and nine months ended September 30, 2018 have substantially increased as compared to the corresponding periods in 2017.

In accordance with the authoritative guidance for income taxes, each interim period is considered an integral part of the annual period and tax expense or benefit is measured using an estimated annual effective income tax rate. The estimated annual effective tax rate for the full year is applied to the respective interim period, taking into account year-to-date amounts and projected amounts for the year. Since the Company operates in foreign countries with varying tax rates, the magnitude of the impact of the results the international operations has on the Company's quarterly effective tax rate is dependent on the level of income or loss from the international operations in the period.

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

The Company had gross unrecognized tax benefits, inclusive of penalties and interest, of $21.6 million at September 30, 2018. These unrecognized tax benefits, if recognized, would result in a net tax benefit of $9.7 million as of September 30, 2018. The gross unrecognized tax benefits did not materially change from December 31, 2017.

Of the $204.6 million of cash and cash equivalents as of September 30, 2018, $171.9 million was held outside of the United States. Following the enactment of the Tax Reform Act and the associated transition tax, in general, repatriation of cash to the United States can be completed with no incremental U.S. tax. However, repatriation of cash could subject the Company to non-U.S. jurisdictional taxes on distributions. The Company maintains non-U.S. funds in its foreign operations to (i) provide adequate working capital, (ii) satisfy various regulatory requirements, and (iii) take advantage of business expansion opportunities as they arise. The non-U.S. jurisdictional taxes applicable to foreign earnings are not readily determinable or practicable. The Company continues to evaluate the impact of the Tax Reform Act on its election to indefinitely reinvest certain of its non-U.S. earnings. As of September 30, 2018, management believes that it has sufficient liquidity to satisfy its cash needs, including its cash needs in the United States.

Note 12: Commitments and Contingencies

Litigation and Regulatory

The Company is involved in disputes, legal actions, regulatory investigations, inquiries, and other actions from time to time in the ordinary course of business. The Company, along with others in its industry, is routinely subject to legal actions based on the Fair Debt Collection Practices Act ("FDCPA"), comparable state statutes, the Telephone Consumer

Protection Act ("TCPA"), state and federal unfair competition statutes, and common law causes of action. The violations of law investigated or alleged in these actions often include claims that the Company lacks specified licenses to conduct its business, attempts to collect debts on which the statute of limitations has run, has made inaccurate or unsupported assertions of fact in support of its collection actions and/or has acted improperly in connection with its efforts to contact consumers. Such litigation and regulatory actions could involve potential compensatory or punitive damage claims, fines, sanctions, injunctive relief, or

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changes in business practices. Many continue on for some length of time and involve substantial investigation, litigation, negotiation, and other expense and effort before a result is achieved, and during the process the Company often cannot determine the substance or timing of any eventual outcome.

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

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

Purchase Commitments

In the normal course of business, the Company enters into forward flow purchase agreements and other purchase commitment agreements. As of September 30, 2018, the Company has entered into agreements to purchase receivable portfolios with a face value of approximately $2.5 billion for a purchase price of approximately $392.9 million. Most purchase commitments do not extend past one year.

Note 13: Segment and Geographic Information

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues, adjusted by net allowances(1):				
United States	$178,892	$154,815	$530,679	$498,744
International				
Europe(2)	137,331	127,687	412,407	300,379
Other geographies	20,551	24,197	70,223	70,434
	157,882	151,884	482,630	370,813
Total	$336,774	$306,699	$1,013,309	$869,557

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

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

Note 14: Goodwill and Identifiable Intangible Assets

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

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

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

	Total
Balance, December 31, 2017	$928,993
Goodwill adjustments	(2,212)
Effect of foreign currency translation	(28,190)
Balance, September 30, 2018	$898,591

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

	As of September 30, 2018			As of December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	$71,895	$ (11,796)	$60,099	$73,875	$ (6,800)	$67,075
Developed technologies	5,710	(5,247)	463	6,683	(5,411)	1,272
Trade name and other	9,500	(5,995)	3,505	14,413	(7,024)	7,389
Total intangible assets	$87,105	$ (23,038)	$64,067	$94,971	$ (19,235)	$75,736

Note 15: Guarantee of Subsidiary Debt

Unless otherwise indicated in connection with a particular offering of debt securities, Encore will fully and unconditionally guarantee any debt securities issued by Encore Finance, a 100% owned finance subsidiary of Encore. Amounts related to Encore Finance are included in the consolidated financial statements of Encore subsequent to April 30, 2018, the date of the incorporation of Encore Finance. On July 20, 2018, Encore Finance issued $172.5 million aggregate principal amount of the Exchangeable Notes which are fully and unconditionally guaranteed by Encore. Refer to Note 9, "Debt, Net," for further details of the Exchangeable Notes.

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

This Quarterly Report on Form 10-Q contains "forward-looking statements" relating to Encore Capital Group, Inc. ("Encore") and its subsidiaries (which we may collectively refer to as the "Company," "we," "our" or "us") within the meaning of the securities laws. The words "believe," "expect," "anticipate," "estimate," "project," "intend," "plan," "will," "may," and s expressions often characterize forward-looking statements. These statements may include, but are not limited to, projections of collections, revenues, income or loss, estimates of capital expenditures, plans for future operations, products or services and financing needs or plans, as well as assumptions relating to these matters. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we caution that these expectations or predictions may not prove to be correct or we may not achieve the financial results, savings, or other benefits anticipated in the forward-looking statements. These forward-looking statements are necessarily estimates reflecting the best judgment of our senior management and involve a number of risks and uncertainties, some of which may be beyond our control or cannot be predicted or quantified, that could cause actual results to differ materially from those suggested by the forward-looking statements. Many factors including, but not limited to, those set forth in our Annual Report on Form 10-K under "Part I, Item 1A. Risk Factors," could cause our actual results, performance, achievements, or industry results to be very different from the results, performance, achievements or industry results expressed or implied by these forward-looking statements. Our business, financial condition, or results of operations could also be materially and adversely affected by other factors besides those

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listed. Forward-looking statements speak only as of the date the statements were made. We do not undertake any obligation to update or revise any forward-looking statements to reflect new information or future events, or for any other reason, even if experience or future events make it clear that any expected results expressed or implied by these forward-looking statements will not be realized. In addition, it is generally our policy not to make any specific projections as to future earnings, and we do not endorse projections regarding future performance that may be made by third parties.

Our Business

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

United States

Our subsidiary Midland Credit Management (together with its subsidiaries and domestic affiliates, "Midland") is a market leader in portfolio purchasing and recovery in the United States, including Puerto Rico.

Europe

Cabot Credit Management plc (together with its subsidiaries, "Cabot"), our largest international subsidiary, is one of the largest credit management services providers in Europe and is a market leader in the United Kingdom and Ireland. Cabot, in addition to its primary business of portfolio purchasing and recovery, also provides a range of debt servicing offerings such as early stage collections, business process outsourcing ("BPO"), contingent collections, trace services and litigation activities. Cabot strengthened its debt servicing offerings with the acquisition of Wescot Credit Services Limited ("Wescot"), a leading U.K. contingency debt collection and BPO services company in November 2017. Previously we controlled Cabot via our majority ownership interest in the indirect holding company of Cabot, Janus Holdings Luxembourg S.à r.l. ("Janus Holdings"). On July 24, 2018, we completed the purchase of all of the outstanding equity of Cabot not owned by us (the "Cabot Transaction"). As a result, Cabot became a wholly owned subsidiary of Encore.

Latin America

Our majority-owned subsidiary, Refinancia S.A.S. (together with its subsidiaries, "Refinancia"), is a market leader in debt collection and management in Colombia and Peru. In addition to purchasing defaulted receivables, Refinancia offers portfolio management services to banks for non-performing loans. Refinancia also specializes in non-traditional niches in the geographic areas in which it operates, including point-of-purchase lending to consumers and providing financial solutions to individuals who have previously defaulted on their credit obligations.

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

Asia Pacific

Our subsidiary, Baycorp Holdings Pty Limited (together with its subsidiaries, "Baycorp"), specializes in the management of non-performing loans in Australia and New Zealand. In addition to purchasing defaulted receivables, Baycorp offers portfolio management services to banks for non-performing loans.

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

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

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Government Regulation

United States

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

International

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

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

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

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

Portfolio Purchasing and Recovery

United States

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

While seasonality does not have a material impact on our business, collections are generally strongest in our first calendar quarter, slower in the second and third calendar quarters, and slowest in the fourth calendar quarter. Relatively higher collections in the first quarter could result in a lower cost-to-collect ratio compared to the other quarters, as our fixed costs are relatively constant and applied against a larger collection base. The seasonal impact on our business may also be influenced by our purchasing levels, the types of portfolios we purchase, and our operating strategies.

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

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

International

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

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

Purchases and Collections

Portfolio Pricing, Supply and Demand

United States

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

We believe that smaller competitors continue to face difficulties in the portfolio purchasing market because of the high cost to operate due to regulatory pressure and because issuers are being more selective with buyers in the marketplace, resulting in consolidation within the portfolio purchasing and recovery industry. We believe this favors larger participants, such as Encore, because the larger market participants are better able to adapt to these pressures.

International

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

The Spanish debt market continues to be one of the largest in Europe with a significant amount of debt to be sold and serviced. In particular, we anticipate strong debt purchasing and servicing opportunities in the secured and small and medium enterprise asset classes given the backlog of non-performing debt that has accumulated in these sectors. Additionally, financial institutions continue to experience both market and regulatory pressure to dispose of non-performing loans which should further increase debt purchasing opportunities in Spain.

Although pricing has been elevated, we believe that as our European businesses increase in scale and expand to other markets, and with continued improvements in liquidation and improved efficiencies in collections, our margins will remain competitive. Additionally, Cabot’s continuing investment in its litigation liquidation channel has enabled them to collect from

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consumers who have the ability to pay but have so far been unwilling to do so. This also enables Cabot to mitigate some of the impact of elevated pricing.

Purchases by Geographic Location

In the United States, the defaulted consumer receivable portfolios we purchase are primarily charged-off credit card debt portfolios. A small percentage of our capital deployment in the United States comprises of receivable portfolios subject to Chapter 13 and Chapter 7 bankruptcy proceedings.

In Europe, our purchased under-performing debt portfolios primarily consist of paying and non-paying consumer loan accounts. We also purchase certain secured mortgage portfolios and portfolios that are in insolvency status, in particular, individual voluntary arrangements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
United States	$122,783	$111,160	$504,333	$366,320
Europe	114,988	177,266	349,315	354,636
Other geographies	10,920	3,906	31,385	36,518
Total purchases	$248,691	$292,332	$885,033	$757,474

During the three months ended September 30, 2018, we invested $248.7 million to acquire receivable portfolios, with face values aggregating $1.6 billion, for an average purchase price of 15.9% of face value. The amount invested in receivable portfolios decreased $43.6 million, or 14.9%, compared with the $292.3 million invested during the three months ended September 30, 2017, to acquire receivable portfolios with face values aggregating $3.0 billion, for an average purchase price of 9.7% of face value.

During the nine months ended September 30, 2018, we invested $885.0 million to acquire receivable portfolios, with face values aggregating $6.2 billion, for an average purchase price of 14.2% of face value. The amount invested in receivable portfolios increased $127.6 million, or 16.8%, compared with the $757.5 million invested during the nine months ended September 30, 2017, to acquire receivable portfolios with face values aggregating $7.1 billion, for an average purchase price of 10.6% of face value.

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

In Europe, capital deployment for the three and nine months ended September 30, 2018 decreased as compared to the corresponding periods in the prior year. The decreases were primarily the result of a significant amount of capital deployment at Cabot during the third quarter of 2017 due to a large volume of portfolios offered for sale in the U.K. market.

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

Collections by Channel and Geographic Location

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

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
United States[1]:				
Collection sites	$170,573	$128,199	$497,343	$397,981
Legal collections	143,718	134,011	417,315	421,984
Collection agencies	4,119	6,698	13,524	22,883
Subtotal	318,410	268,908	928,182	842,848
Europe:				
Collection sites	66,853	75,940	225,657	226,139
Legal collections	42,333	26,956	109,580	88,469
Collection agencies	44,279	41,046	137,338	87,980
Subtotal	153,465	143,942	472,575	402,588
Other geographies:				
Collection sites	21,767	23,797	66,197	66,232
Legal collections	1,957	2,108	6,368	5,757
Collection agencies	3,244	4,241	10,716	12,616
Subtotal	26,968	30,146	83,281	84,605
Total collections	$498,843	$442,996	$1,484,038	$1,330,041

(1) Certain reclassifications have been made between collection agencies and collections sites for prior periods.

Gross collections increased by $55.8 million, or 12.6%, to $498.8 million during the three months ended September 30, 2018, from $443.0 million during the three months ended September 30, 2017. Gross collections increased by $154.0 million, or 11.6%, to $1,484.0 million during the nine months ended September 30, 2018, from $1,330.0 million during the nine months ended September 30, 2017.

The increase of collections in the United States during the three and nine months ended September 30, 2018 as compared to the corresponding periods in the prior year was primarily due to the acquisition of portfolios with higher returns in recent periods, the increase in our collection capacity, and our continued effort in improving liquidation.

The increase in collections in Europe during the three months ended September 30, 2018 as compared to the corresponding period in the prior year was primarily the result of implementing certain liquidation improvement initiatives. The increase in collections in Europe during the nine months ended September 30, 2018 as compared to the corresponding period in the prior year was primarily the result of implementing certain liquidation improvement initiatives and the favorable impact of foreign currency translation, which was primarily the result of the weakening of the U.S. dollar against the British Pound.

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Results of Operations

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

	Three Months Ended September 30,			
	2018		2017	
Revenues				
Revenue from receivable portfolios	$295,357	87.7 %	$264,024	86.1 %
Other revenues	37,388	11.1 %	23,111	7.5 %
Total revenues	332,745	98.8 %	287,135	93.6 %
Allowance reversals on receivable portfolios, net	4,029	1.2 %	19,564	6.4 %
Total revenues, adjusted by net allowances	336,774	100.0 %	306,699	100.0 %
Operating expenses				
Salaries and employee benefits	95,634	28.4 %	77,232	25.2 %
Cost of legal collections	50,473	15.0 %	48,094	15.7 %
Other operating expenses	30,691	9.1 %	25,859	8.4 %
Collection agency commissions	10,682	3.2 %	10,622	3.4 %
General and administrative expenses	41,893	12.4 %	32,500	10.6 %
Depreciation and amortization	9,873	2.9 %	8,522	2.8 %
Total operating expenses	239,246	71.0 %	202,829	66.1 %
Income from operations	97,528	29.0 %	103,870	33.9 %
Other (expense) income				
Interest expense	(65,094)	(19.3)%	(52,755)	(17.2)%
Other (expense) income	(2,539)	(0.8)%	8,873	2.9 %
Total other expense	(67,633)	(20.1)%	(43,882)	(14.3)%
Income from continuing operations before income taxes	29,895	8.9 %	59,988	19.6 %
Provision for income taxes	(16,879)	(5.0)%	(17,844)	(5.9)%
Net income	13,016	3.9 %	42,144	13.7 %
Net (income) loss attributable to noncontrolling interest	7,709	2.3 %	(13,950)	(4.5)%
Net income attributable to Encore Capital Group, Inc. stockholders	$20,725	6.2 %	$28,194	9.2 %

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	Nine Months Ended September 30, 2018			
	2018		2017	
Revenues				
Revenue from receivable portfolios	$869,028	85.8 %	$777,269	89.4 %
Other revenues	112,809	11.1 %	61,763	7.1 %
Total revenues	981,837	96.9 %	839,032	96.5 %
Allowance reversals on receivable portfolios, net	31,472	3.1 %	30,525	3.5 %
Total revenues, adjusted by net allowances	1,013,309	100.0 %	869,557	100.0 %
Operating expenses				
Salaries and employee benefits	275,853	27.2 %	221,296	25.4 %
Cost of legal collections	155,583	15.4 %	149,460	17.2 %
Other operating expenses	103,478	10.2 %	76,249	8.8 %
Collection agency commissions	34,587	3.4 %	33,678	3.9 %
General and administrative expenses	123,163	12.2 %	102,750	11.8 %
Depreciation and amortization	31,232	3.1 %	25,819	3.0 %
Total operating expenses	723,896	71.4 %	609,252	70.1 %
Income from operations	289,413	28.6 %	260,305	29.9 %
Other (expense) income				
Interest expense	(183,092)	(18.1)%	(152,469)	(17.5)%
Other (expense) income	(4,961)	(0.5)%	12,004	1.4 %
Total other expense	(188,053)	(18.6)%	(140,465)	(16.1)%
Income from continuing operations before income taxes	101,360	10.0 %	119,840	13.8 %
Provision for income taxes	(37,657)	(3.7)%	(43,442)	(5.0)%
Income from continuing operations	63,703	6.3 %	76,398	8.8 %
Loss from discontinued operations, net of tax	—	—	(199)	0.0 %
Net income	63,703	6.3 %	76,199	8.8 %
Net (income) loss attributable to noncontrolling interest	5,147	0.5 %	(5,652)	(0.7)%
Net income attributable to Encore Capital Group, Inc. stockholders	$68,850	6.8 %	$70,547	8.1 %

Results of Operations—Cabot

The following table summarizes the operating results contributed by Cabot during the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Total revenues, adjusted by net allowances	$130,513	$120,914	$387,379	$280,743
Total operating expenses	(72,343)	(51,034)	(215,344)	(142,864)
Income from operations	58,170	69,880	172,035	137,879
Interest expense-non-PEC	(36,169)	(27,632)	(96,196)	(80,355)
PEC interest expense	(1,952)	(6,626)	(17,307)	(19,177)
Other income	523	6,808	1,114	9,348
Income before income taxes	20,572	42,430	59,646	47,695
Provision for income taxes	(5,373)	(8,374)	(14,614)	(11,556)
Net income	15,199	34,056	45,032	36,139
Net loss (income) attributable to noncontrolling interest	3,674	(15,718)	(5,068)	(10,106)
Net income attributable to Encore Capital Group, Inc. stockholders	$18,873	$18,338	$39,964	$26,033

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Comparison of Results of Operations

Revenues

Our revenues consist of revenue from receivable portfolios and other revenues.

Revenue from receivable portfolios 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 portfolio allowances. The effective interest rate is the internal rate of return ("IRR") 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, or Zero Basis Portfolios ("ZBA"), are recorded as revenue, or zero basis revenue. We account for our investment in receivable portfolios utilizing the interest method in accordance with the authoritative guidance for loans and debt securities acquired with deteriorated credit quality.

Other revenues consist primarily of fee-based income earned on accounts collected on behalf of others, primarily credit originators. Certain of the Company's international subsidiaries earn fee-based income by providing debt servicing (such as early stage collections, BPO, contingent collections, trace services and litigation activities) to credit originators for non-performing loans.

We may incur allowance charges when actual cash flows from our receivable portfolios underperform compared to our expectations or when there is a change in the timing of cash flows. Factors that may contribute to underperformance and to the recording of valuation allowances may include both internal as well as external factors. Internal factors that may have an impact on our collections include operational activities, such as capacity and the productivity of our collection staff. External factors that may have an impact on our collections include new laws or regulations, new interpretations of existing laws or regulations, and the overall condition of the economy. We record allowance reversals on pool groups that have historic allowance reserves when actual cash flows from these receivable portfolios outperform our expectations.

Total revenues, adjusted by net allowances, were $336.8 million during the three months ended September 30, 2018, an increase of $30.1 million, or 9.8%, compared to total revenues, adjusted by net allowances of $306.7 million during the three months ended September 30, 2017. Total revenues, adjusted by net allowances, were $1,013.3 million during the nine months ended September 30, 2018, an increase of $143.7 million, or 16.5%, compared to total revenues, adjusted by net allowances of $869.6 million during the nine months ended September 30, 2017.

Our operating results are impacted by foreign currency translation, which represents the effect of translating operating results where the functional currency is different than our U.S. dollar reporting currency. The strengthening of the U.S. dollar relative to other foreign currencies has an unfavorable impact on our international revenues, and the weakening of the U.S. dollar relative to other foreign currencies has a favorable impact on our international revenues. The impact from foreign currency translation on our revenues was insignificant due to relatively consistent foreign currency exchange rate between U.S. dollar and the British Pound during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017. Our revenues were favorably impacted by foreign currency translation, primarily by the weakening of the U.S. dollar against the British Pound by 5.6% for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

Revenue from receivable portfolios was $295.4 million during the three months ended September 30, 2018, an increase of $31.4 million, or 11.9%, compared to $264.0 million during the three months ended September 30, 2017. The increase in portfolio revenue during the three months ended September 30, 2018 compared to the three months ended September 30, 2017 was due to increased purchase volume in recent quarters.

Revenue from receivable portfolios was $869.0 million during the nine months ended September 30, 2018, an increase of $91.7 million, or 11.8%, compared to $777.3 million during the nine months ended September 30, 2017. The increase in portfolio revenue during the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 was due to increased purchase volume in recent quarters and by the favorable impact of foreign currency translation, which was primarily the result of the weakening of the U.S. dollar against the British Pound.

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

	Three Months Ended September 30, 2018					As of September 30, 2018	
	Collections[1]	Gross Revenue	Revenue Recognition Rate	Net Reversal (Portfolio Allowance)	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
United States:							
ZBA[2]	$32,383	$29,568	91.3 %	$ 2,833	10.0 %	$—	—
2011	3,740	3,306	88.4 %	—	1.1 %	3,704	27.5 %
2012	9,051	6,882	76.0 %	—	2.3 %	10,676	18.8 %
2013	25,237	18,787	74.4 %	—	6.4 %	29,048	18.9 %
2014	22,995	11,638	50.6 %	394	3.9 %	78,795	4.5 %
2015	30,169	12,619	41.8 %	(1,709)	4.3 %	142,909	2.7 %
2016	57,161	24,004	42.0 %	(401)	8.1 %	261,557	2.8 %
2017	78,699	34,790	44.2 %	(646)	11.9 %	360,900	3.0 %
2018	58,975	36,745	62.3 %	—	12.4 %	461,910	3.1 %
Subtotal	318,410	178,339	56.0 %	471	60.4 %	1,349,499	3.6 %
Europe:							
ZBA[2]	90	90	100.0 %	—	0.0 %	—	—
2013	31,884	23,882	74.9 %	6,431	8.1 %	252,673	3.1 %
2014	30,545	20,096	65.8 %	—	6.8 %	249,249	2.6 %
2015	20,329	11,897	58.5 %	(62)	4.0 %	196,211	2.0 %
2016	18,002	11,861	65.9 %	—	4.0 %	179,271	2.3 %
2017	35,261	17,200	48.8 %	—	5.8 %	370,498	1.5 %
2018	17,354	12,854	74.1 %	—	4.4 %	335,275	1.5 %
Subtotal	153,465	97,880	63.8 %	6,369	33.1 %	1,583,177	2.1 %
Other geographies:							
ZBA[2]	2,590	2,590	100.0 %	—	0.9 %	—	—
2014	1,304	4,407	338.0 %	—	1.5 %	63,420	2.4 %
2015	7,139	4,628	64.8 %	(1,748)	1.6 %	22,142	6.0 %
2016	6,077	2,524	41.5 %	(1,063)	0.9 %	29,895	2.4 %
2017	5,359	2,793	52.1 %	—	0.9 %	34,850	2.3 %
2018	4,499	2,196	48.8 %	—	0.7 %	26,133	3.3 %
Subtotal	26,968	19,138	71.0 %	(2,811)	6.5 %	176,440	3.0 %
Total	$498,843	$295,357	59.2 %	$ 4,029	100.0 %	$3,109,116	2.8 %

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

(2) Zero basis revenue typically has a 100% revenue recognition rate. However, collections on ZBA pool groups where a valuation allowance remains must first be recorded as an allowance reversal until the allowance for that pool group is zero. Once the entire valuation allowance is reversed, the revenue recognition rate will become 100%. ZBA gross revenue includes an immaterial amount of accounts that are returned to the seller in accordance with the respective purchase agreement (“Put-Backs”).

	Three Months Ended September 30, 2017					As of September 30, 2017	
	Collections[1]	Gross Revenue	Revenue Recognition Rate	Net Reversal (Portfolio Allowance)	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
United States:							
ZBA[2]	$32,460	$30,991	95.5 %	$ 1,747	11.7 %	$—	—
2007	444	6	1.4 %	—	0.0 %	—	0.0 %
2008	1,161	418	36.0 %	—	0.2 %	2,187	5.2 %
2009[3]	—	—	—	—	—	—	—
2010[3]	—	—	—	—	—	—	—
2011	4,584	4,072	88.8 %	—	1.5 %	5,119	25.0 %
2012	17,102	12,035	70.4 %	(2,337)	4.6 %	18,042	18.5 %
2013	32,821	22,843	69.6 %	—	8.7 %	53,250	12.7 %
2014	32,838	17,949	54.7 %	(7,844)	6.8 %	125,059	4.4 %
2015	42,711	18,460	43.2 %	—	7.0 %	222,897	2.6 %
2016	70,750	33,276	47.0 %	—	12.6 %	402,542	2.6 %
2017	34,037	23,185	68.1 %	—	8.8 %	346,524	2.8 %
Subtotal	268,908	163,235	60.7 %	(8,434)	61.9 %	1,175,620	3.6 %
Europe:							
2013	36,767	24,991	68.0 %	26,325	9.5 %	269,158	3.1 %
2014	35,104	21,115	60.1 %	1,673	8.0 %	294,938	2.4 %
2015	24,746	13,513	54.6 %	—	5.1 %	240,126	1.9 %
2016	24,782	11,434	46.1 %	—	4.3 %	215,499	1.9 %
2017	22,543	12,463	55.3 %	—	4.7 %	352,591	1.7 %
Subtotal	143,942	83,516	58.0 %	27,998	31.6 %	1,372,312	2.2 %
Other geographies:							
ZBA[2]	2,666	2,630	98.6 %	—	1.0 %	—	—
2013	172	—	0.0 %	—	0.0 %	308	0.0 %
2014	1,910	4,485	234.8 %	—	1.7 %	61,215	2.4 %
2015	10,976	5,577	50.8 %	—	2.1 %	39,487	4.3 %
2016	8,794	3,453	39.3 %	—	1.3 %	49,979	2.2 %
2017	5,628	1,128	20.0 %	—	0.4 %	29,890	1.4 %
Subtotal	30,146	17,273	57.3 %	—	6.5 %	180,879	2.6 %
Total	$442,996	$264,024	59.6 %	$ 19,564	100.0 %	$2,728,811	2.8 %

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

(2) Zero basis revenue typically has a 100% revenue recognition rate. However, collections on ZBA pool groups where a valuation allowance remains must first be recorded as an allowance reversal until the allowance for that pool group is zero. Once the entire valuation allowance is reversed, the revenue recognition rate will become 100%. ZBA gross revenue includes an immaterial amount of Put-Backs.

(3) Total collections realized exceed the net book value of the portfolio and have been converted to ZBA.

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	Nine Months Ended September 30, 2018					As of September 30, 2018	
	Collections[1]	Gross Revenue	Revenue Recognition Rate	Net Reversal (Portfolio Allowance)	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
United States:							
ZBA[2]	$94,675	$88,063	93.0 %	$ 6,783	10.1 %	$—	—
2008	1,652	237	14.3 %	—	0.0 %	—	—
2009[3]	—	—	—	—	—	—	—
2010[3]	—	—	—	—	—	—	—
2011	10,954	10,081	92.0 %	—	1.2 %	3,704	27.5 %
2012	28,496	23,489	82.4 %	(723)	2.7 %	10,676	18.8 %
2013	81,759	62,230	76.1 %	—	7.2 %	29,048	18.9 %
2014	74,593	39,790	53.3 %	1,299	4.6 %	78,795	4.5 %
2015	100,683	43,054	42.8 %	(1,709)	5.0 %	142,909	2.7 %
2016	186,747	80,046	42.9 %	(401)	9.2 %	261,557	2.8 %
2017	243,525	114,363	47.0 %	(646)	13.2 %	360,900	3.0 %
2018	105,098	64,612	61.5 %	—	7.4 %	461,910	3.1 %
Subtotal	928,182	525,965	56.7 %	4,603	60.6 %	1,349,499	3.6 %
Europe:							
ZBA adjustment[4]	—	798	—	—	0.1 %	—	—
ZBA[2]	108	109	100.9 %	—	0.0 %	—	—
2013	102,073	74,485	73.0 %	20,690	8.6 %	252,673	3.1 %
2014	99,411	62,923	63.3 %	7,956	7.2 %	249,249	2.6 %
2015	67,228	38,050	56.6 %	852	4.4 %	196,211	2.0 %
2016	63,071	38,347	60.8 %	—	4.4 %	179,271	2.3 %
2017	116,312	50,819	43.7 %	—	5.8 %	370,498	1.5 %
2018	24,372	19,861	81.5 %	—	2.3 %	335,275	1.5 %
Subtotal	472,575	285,392	60.4 %	29,498	32.8 %	1,583,177	2.1 %
Other geographies:							
ZBA[2]	8,431	8,430	100.0 %	—	1.0 %	—	—
2013[3]	150	—	0.0 %	—	0.0 %	—	—
2014	4,377	13,015	297.3 %	—	1.5 %	63,420	2.4 %
2015	24,121	15,618	64.7 %	(1,748)	1.8 %	22,142	6.0 %
2016	20,073	9,059	45.1 %	(881)	1.0 %	29,895	2.4 %
2017	18,197	7,741	42.5 %	—	0.9 %	34,850	2.3 %
2018	7,932	3,808	48.0 %	—	0.4 %	26,133	3.3 %
Subtotal	83,281	57,671	69.2 %	(2,629)	6.6 %	176,440	3.0 %
Total	$1,484,038	$869,028	58.6 %	$ 31,472	100 %	$3,109,116	2.8 %

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

(2) Zero basis revenue typically has a 100% revenue recognition rate. However, collections on ZBA pool groups where a valuation allowance remains must first be recorded as an allowance reversal until the allowance for that pool group is zero. Once the entire valuation allowance is reversed, the revenue recognition rate will become 100%. ZBA gross revenue includes an immaterial amount of Put-Backs.

(3) Total collections realized exceed the net book value of the portfolio and have been converted to ZBA.

(4) Adjustment resulting from certain ZBA revenue that was classified as collections in cost recovery portfolios in prior periods.

	Nine Months Ended September 30, 2017					As of September 30, 2017	
	Collections[1]	Gross Revenue	Revenue Recognition Rate	Net Reversal (Portfolio Allowance)	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
United States:							
ZBA[2]	$107,606	$102,900	95.6 %	$ 4,974	13.2 %	$—	—
2007	1,556	210	13.5 %	—	0.0 %	—	0.0 %
2008	3,645	1,589	43.6 %	613	0.2 %	2,187	5.2 %
2009[3]	—	—	—	—	—	—	—
2010	1,106	299	27.0 %	—	0.0 %	—	0.0 %
2011	15,956	13,218	82.8 %	—	1.7 %	5,119	25.0 %
2012	60,098	41,658	69.3 %	(2,337)	5.4 %	18,042	18.5 %
2013	110,290	73,017	66.2 %	—	9.4 %	53,250	12.7 %
2014	114,944	61,117	53.2 %	(7,844)	7.9 %	125,059	4.4 %
2015	149,190	60,677	40.7 %	—	7.8 %	222,897	2.6 %
2016	219,608	108,692	49.5 %	—	14.0 %	402,542	2.6 %
2017	58,849	39,893	67.8 %	—	5.1 %	346,524	2.8 %
Subtotal	842,848	503,270	59.7 %	(4,594)	64.7 %	1,175,620	3.6 %
Europe:							
2013	112,648	71,340	63.3 %	34,128	9.3 %	269,158	3.1 %
2014	104,839	61,622	58.8 %	1,673	7.9 %	294,938	2.4 %
2015	79,373	39,797	50.1 %	—	5.1 %	240,126	1.9 %
2016	72,053	33,452	46.4 %	—	4.3 %	215,499	1.9 %
2017	33,675	17,398	51.7 %	—	2.2 %	352,591	1.7 %
Subtotal	402,588	223,609	55.5 %	35,801	28.8 %	1,372,312	2.2 %
Other geographies:							
ZBA[2]	8,544	8,530	99.8 %	—	1.1 %	—	—
2013	721	—	0.0 %	—	0.0 %	308	0.0 %
2014	6,265	12,406	198.0 %	—	1.7 %	61,215	2.4 %
2015	32,093	16,555	51.6 %	—	2.1 %	39,487	4.3 %
2016	27,715	11,032	39.8 %	(682)	1.4 %	49,979	2.2 %
2017	9,267	1,867	20.1 %	—	0.2 %	29,890	1.4 %
Subtotal	84,605	50,390	59.6 %	(682)	6.5 %	180,879	2.6 %
Total	$1,330,041	$777,269	58.4 %	$ 30,525	100.0 %	$2,728,811	2.8 %

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

(2) Zero basis revenue typically has a 100% revenue recognition rate. However, collections on ZBA pool groups where a valuation allowance remains must first be recorded as an allowance reversal until the allowance for that pool group is zero. Once the entire valuation allowance is reversed, the revenue recognition rate will become 100%. ZBA gross revenue includes an immaterial amount of Put-Backs.

(3) Total collections realized exceed the net book value of the portfolio and have been converted to ZBA.

Other revenues were $37.4 million and $23.1 million for the three months ended September 30, 2018 and 2017, respectively, and $112.8 million and $61.8 million for the nine months ended September 30, 2018 and 2017, respectively. Other revenues primarily consist of fee-based income earned at our international subsidiaries that provide portfolio management services to credit originators for non-performing loans. The increase in other revenues in the periods presented was primarily attributable to additional fee-based income earned from recently acquired fee-based service providers, primarily from the acquisition of Wescot, which was completed in November 2017.

Net allowance reversals were $4.0 million and $19.6 million during the three months ended September 30, 2018 and 2017, respectively, and $31.5 million and $30.5 million for the nine months ended September 30, 2018 and 2017, respectively. During the three months ended September 30, 2018, we recorded a total allowance reversal of $10.2 million. This allowance reversal was partially offset by a portfolio allowance of $6.2 million recorded on certain pools with shortfalls on projected cash flows. The allowance reversal was primarily a result of sustained improvements in portfolio collections on certain European portfolios on which we had previously recorded large portfolio allowances in the past. These improvements in portfolio collections were driven by liquidation improvement initiatives.

Operating Expenses

Total operating expenses were $239.2 million during the three months ended September 30, 2018, an increase of $36.4 million, or 17.9%, compared to total operating expenses of $202.8 million during the three months ended September 30, 2017. Total operating expenses were $723.9 million during the nine months ended September 30, 2018, an increase of $114.6 million, or 18.8%, compared to total operating expense of $609.3 million during the nine months ended September 30, 2017.

The increases in operating expenses during the three and nine months ended September 30, 2018, as compared to the corresponding periods in 2017, were primarily the result of expenses associated with Wescot, which was acquired in November 2017, the Cabot Transaction, and collections capacity expansion in the U.S.

Additionally, our operating results are impacted by foreign currency translation, which represents the effect of translating operating results where the functional currency is different than our U.S. dollar reporting currency. The strengthening of the U.S. dollar relative to other foreign currencies has a favorable impact on our international operating expenses, and the weakening of the U.S. dollar relative to other foreign currencies has an unfavorable impact on our international operating expenses. The impact from foreign currency translation on our operating expenses was not significant due to a relatively consistent foreign currency exchange rate between the U.S. dollar and British Pound during the three months ended September 30, 2018 as compared to the three months ended September 30, 2017. Our operating expenses were unfavorably impacted by foreign currency translation, primarily by the weakening of the U.S. dollar against the British Pound by 5.6% for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

Operating expenses are explained in more detail as follows:

Salaries and Employee Benefits

Salaries and employee benefits increased by $18.4 million, or 23.8%, to $95.6 million during the three months ended September 30, 2018, from $77.2 million during the three months ended September 30, 2017. Salaries and employee benefits increased by $54.6 million, or 24.7%, to $275.9 million during the nine months ended September 30, 2018, from $221.3 million during the nine months ended September 30, 2017. The increase was primarily the result of the integration of Wescot and an increase in headcount at our domestic sites as part of initiatives to increase collections capacity and an increase at our international subsidiaries resulting from recent acquisitions.

Stock-based compensation increased $1.5 million, or 41.9%, to $5.0 million during the three months ended September 30, 2018, from $3.5 million during the three months ended September 30, 2017. Stock-based compensation increased $3.5 million, or 48.6%, to $10.5 million during the nine months ended September 30, 2018, from $7.0 million during the nine months ended September 30, 2017. The increase was primarily attributable to larger expense reversals during the prior year as compared to the corresponding periods in the current year and increased expenses related to the Cabot Transaction.

Cost of Legal Collections

Cost of legal collections primarily includes contingent fees paid to our network of attorneys and the cost of litigation. We pursue legal collections using a network of attorneys that specialize in collection matters and through our internal legal channel. Under the agreements with our contracted attorneys, we advance certain out-of-pocket court costs, or Deferred Court Costs. We capitalize these costs in the consolidated financial statements and provide a reserve for those costs that we believe will ultimately be uncollectible. We determine the reserve based on our analysis of historical court costs recovery data.

During the three months ended September 30, 2018, overall cost of legal collections increased $2.4 million, or 4.9%, to $50.5 million, as compared to $48.1 million during the corresponding period in the prior year. The cost of legal collections in the United States increased by $2.9 million, or 7.2% and the cost of legal collections in Europe decreased by $0.5 million, or 7.7% during the three months ended September 30, 2018, as compared to the corresponding period in the prior year. The cost of legal collections as a percentage of gross collections through this channel was 26.8% during the three months ended September 30, 2018, a decrease from 29.5% during the corresponding period in 2017. The cost of legal collections as a percentage of gross collections through this channel in the United States was consistent at 30.5% during the three months ended September 30, 2018 and 2017. The cost of legal collections as a percentage of gross collections through this channel in Europe was 14.7% and 25.1% during the three months ended September 30, 2018 and 2017.

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During the nine months ended September 30, 2018, overall cost of legal collections increased $6.1 million, or 4.1%, to $155.6 million, as compared to $149.5 million during the corresponding period in the prior year. The cost of legal collections in the United States increased slightly by $3.1 million, or 2.4% and cost of legal collections in Europe increased by $3.4 million, or 18.3% during the nine months ended September 30, 2018, as compared to the corresponding period in the prior year. The cost of legal collections as a percentage of gross collections through this channel was consistent at 29.2% during the nine months ended September 30, 2018 and 2017. The cost of legal collections as a percentage of gross collections through this channel in the United States was 31.7% and 30.7% during the nine months ended September 30, 2018 and 2017, respectively. The cost of le