

PORTFOLIO RECOVERY ASSOCIATES INC

Form 10-Q

May 10, 2012

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended March 31, 2012.

.. **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: 000-50058

**Portfolio Recovery Associates, Inc.**

(Exact name of registrant as specified in its charter)

Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

**Delaware**  
 (State or other jurisdiction of  
 incorporation or organization)

**75-3078675**  
 (I.R.S. Employer  
 Identification No.)

**120 Corporate Boulevard, Norfolk, Virginia**  
 (Address of principal executive offices)

**23502**  
 (zip code)

**(888) 772-7326**

(Registrant's telephone number, including area code)

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 past 90 days. YES  NO

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

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

Large accelerated filer  Accelerated filer   
 Non-accelerated filer  Smaller reporting company

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

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

Class	Outstanding as of May 8, 2012
Common Stock, \$0.01 par value	17,105,510

**Table of Contents**

**PORTFOLIO RECOVERY ASSOCIATES, INC.**

**INDEX**

	<b>Page(s)</b>
<b>PART I. <u>FINANCIAL INFORMATION</u></b>	
<b>Item 1. <u>Financial Statements</u></b>	3
<u>Consolidated Balance Sheets (unaudited) as of March 31, 2012 and December 31, 2011</u>	3
<u>Consolidated Income Statements (unaudited) for the three months ended March 31, 2012 and 2011</u>	4
<u>Consolidated Statements of Comprehensive Income (unaudited) for the three months ended March 31, 2012 and 2011</u>	5
<u>Consolidated Statement of Changes in Stockholders' Equity (unaudited) for the three months ended March 31, 2012</u>	6
<u>Consolidated Statements of Cash Flows (unaudited) for the three months ended March 31, 2012 and 2011</u>	7
<u>Notes to Consolidated Financial Statements (unaudited)</u>	8-24
<b>Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	25-51
<b>Item 3. <u>Quantitative and Qualitative Disclosure About Market Risk</u></b>	51
<b>Item 4. <u>Controls and Procedures</u></b>	52
<b>PART II. <u>OTHER INFORMATION</u></b>	
<b>Item 1. <u>Legal Proceedings</u></b>	52
<b>Item 1A. <u>Risk Factors</u></b>	52
<b>Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	53
<b>Item 3. <u>Defaults Upon Senior Securities</u></b>	53
<b>Item 4. <u>Mine Safety Disclosure</u></b>	53
<b>Item 5. <u>Other Information</u></b>	53
<b>Item 6. <u>Exhibits</u></b>	53
<b><u>SIGNATURES</u></b>	54

**Table of Contents****Part I. FINANCIAL INFORMATION****Item 1. Financial Statements****PORTFOLIO RECOVERY ASSOCIATES, INC.****CONSOLIDATED BALANCE SHEETS****March 31, 2012 and December 31, 2011****(unaudited)****(Amounts in thousands, except per share amounts)**

	<b>March 31, 2012</b>	<b>December 31, 2011</b>
<b>Assets</b>		
Cash and cash equivalents	\$ 28,068	\$ 26,697
Finance receivables, net	945,242	926,734
Accounts receivable, net	9,107	7,862
Property and equipment, net	26,369	25,727
Goodwill	97,480	61,678
Intangible assets, net	27,179	14,596
Other assets	8,581	7,829
<b>Total assets</b>	<b>\$ 1,142,026</b>	<b>\$ 1,071,123</b>
<b>Liabilities and Equity</b>		
<b>Liabilities:</b>		
Accounts payable	\$ 10,915	\$ 7,439
Accrued expenses and other liabilities	7,852	6,076
Income taxes payable	16,688	13,109
Accrued payroll and bonuses	6,854	16,036
Net deferred tax liability	194,286	193,898
Line of credit	265,000	220,000
Long-term debt	936	1,246
<b>Total liabilities</b>	<b>502,531</b>	<b>457,804</b>
<b>Commitments and contingencies (Note 13)</b>		
Redeemable noncontrolling interest	18,783	17,831
<b>Stockholders' equity:</b>		
Preferred stock, par value \$0.01, authorized shares, 2,000, issued and outstanding shares - 0		
Common stock, par value \$0.01, 60,000 authorized shares, 17,175 issued and outstanding shares at March 31, 2012, and 17,134 issued and outstanding shares at December 31, 2011	172	171
Additional paid-in capital	166,133	167,719
Retained earnings	453,060	427,598
Accumulated other comprehensive income	1,347	

Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

Total stockholders' equity	620,712	595,488
Total liabilities and equity	\$ 1,142,026	\$ 1,071,123

*The accompanying notes are an integral part of these consolidated financial statements.*

**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****CONSOLIDATED INCOME STATEMENTS****For the three months ended March 31, 2012 and 2011****(unaudited)****(Amounts in thousands, except per share amounts)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>Revenues:</b>		
Income recognized on finance receivables, net	\$ 124,226	\$ 95,974
Fee income	15,920	15,803
<b>Total revenues</b>	<b>140,146</b>	<b>111,777</b>
<b>Operating expenses:</b>		
Compensation and employee services	39,694	34,153
Legal collection fees	7,617	5,749
Legal collection costs	23,669	9,338
Agent fees	1,627	2,639
Outside fees and services	5,860	3,414
Communications	8,253	6,313
Rent and occupancy	1,611	1,398
Depreciation and amortization	3,656	3,216
Other operating expenses	3,738	2,852
<b>Total operating expenses</b>	<b>95,725</b>	<b>69,072</b>
Income from operations	44,421	42,705
<b>Other income and (expense):</b>		
Interest income	1	
Interest expense	(2,653)	(2,867)
Income before income taxes	41,769	39,838
Provision for income taxes	16,580	16,129
Net income	\$ 25,189	\$ 23,709
Adjustment for loss (income) attributable to redeemable noncontrolling interest	273	(588)
Net income attributable to Portfolio Recovery Associates, Inc.	\$ 25,462	\$ 23,121
<b>Net income per common share attributable to Portfolio Recovery Associates, Inc.:</b>		
Basic	\$ 1.48	\$ 1.35

Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

Diluted	\$ 1.47	\$ 1.34
Weighted average number of shares outstanding:		
Basic	17,196	17,092
Diluted	17,267	17,199

*The accompanying notes are an integral part of these consolidated financial statements.*

**Table of Contents**

**PORTFOLIO RECOVERY ASSOCIATES, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**For the three months ended March 31, 2012 and 2011**

**(unaudited)**

**(Amounts in thousands)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	<b>2011</b>
	<b>2012</b>	<b>2011</b>
Net income	\$ 25,189	\$ 23,709
Other comprehensive income:		
Foreign currency translation adjustments	1,347	
Total other comprehensive income	1,347	
Comprehensive income	26,536	23,709
Comprehensive loss/(income) attributable to noncontrolling interest	273	(588)
Comprehensive income attributable to Portfolio Recovery Associates, Inc.	\$ 26,809	\$ 23,121

*The accompanying notes are an integral part of these consolidated financial statements.*



**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY****For the three months ended March 31, 2012****(unaudited)****(Amounts in thousands)**

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders Equity
Balance at December 31, 2011	17,134	\$ 171	\$ 167,719	\$ 427,598	\$	\$ 595,488
Components of comprehensive income:						
Net income attributable to Portfolio Recovery Associates, Inc.				25,462		25,462
Foreign currency translation adjustment					1,347	1,347
Vesting of nonvested shares	72	1	(1)			
Repurchase and cancellation of common stock	(31)		(2,081)			(2,081)
Amortization of share-based compensation			2,347			2,347
Income tax benefit from share-based compensation			1,440			1,440
Employee stock relinquished for payment of taxes			(2,066)			(2,066)
Adjustment of the noncontrolling interest measurement amount			(1,225)			(1,225)
Balance at March 31, 2012	17,175	\$ 172	\$ 166,133	\$ 453,060	\$ 1,347	\$ 620,712

*The accompanying notes are an integral part of these consolidated financial statements.*

**Table of Contents**

**PORTFOLIO RECOVERY ASSOCIATES, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**For the three months ended March 31, 2012 and 2011**

(unaudited)

(Amounts in thousands)

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 25,189	\$ 23,709
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Amortization of share-based compensation	2,347	2,614
Depreciation and amortization	3,656	3,216
Deferred tax expense	403	14,072
<b>Changes in operating assets and liabilities:</b>		
Other assets	711	842
Accounts receivable	2,922	1,563
Accounts payable	(3,687)	4,271
Income taxes	1,118	3,940
Accrued expenses	(3,419)	(1,762)
Accrued payroll and bonuses	(9,181)	(9,145)
Net cash provided by operating activities	20,059	43,320
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(1,152)	(2,163)
Acquisition of finance receivables, net of buybacks	(108,176)	(106,405)
Collections applied to principal on finance receivables	93,770	70,743
Business acquisition, net of cash acquired	(48,653)	
Net cash used in investing activities	(64,211)	(37,825)
<b>Cash flows from financing activities:</b>		
Proceeds from exercise of options		149
Income tax benefit from share-based compensation	1,440	294
Proceeds from line of credit	95,000	2,000
Principal payments on line of credit	(50,000)	(12,000)
Repurchases of common stock	(2,081)	
Distributions paid to noncontrolling interest		(1,291)
Principal payments on long-term debt	(310)	(298)
Net cash provided by/(used in) financing activities	44,049	(11,146)
Effect of exchange rate on cash	1,474	
Net increase/(decrease) in cash and cash equivalents	1,371	(5,651)

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

Cash and cash equivalents, beginning of year	26,697	41,094
Cash and cash equivalents, end of period	\$ 28,068	\$ 35,443
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 2,557	\$ 2,711
Cash paid for income taxes	12,497	15
Noncash investing and financing activities:		
Adjustment of the noncontrolling interest measurement amount	\$ (1,225)	\$ (985)
Distributions payable relating to noncontrolling interest		769
Employee stock relinquished for payment of taxes	(2,066)	
<i>The accompanying notes are an integral part of these consolidated financial statements.</i>		

**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****1. Organization and Business:**

Portfolio Recovery Associates, Inc., a Delaware corporation, and its subsidiaries (collectively, the Company) is a specialized financial and business service company. Its primary business is the purchase, collection and management of portfolios of defaulted consumer receivables. The Company also services receivables on behalf of clients on either a commission or transaction-fee basis as well as providing class action claims settlement recovery services and related payment processing to its corporate clients.

The consolidated financial statements of the Company are prepared in accordance with U.S. generally accepted accounting principles and include the accounts of all of its subsidiaries. All significant intercompany accounts and transactions have been eliminated. Under the guidance of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 280 Segment Reporting (ASC 280), the Company has determined that it has several operating segments that meet the aggregation criteria of ASC 280, and therefore, it has one reportable segment, accounts receivable management, based on similarities among the operating units including homogeneity of services, service delivery methods and use of technology.

With the acquisition of Mackenzie Hall Holdings Limited and its subsidiaries (MHH) on January 16, 2012, the Company began doing business in the United Kingdom. The assets, liabilities and operations of its foreign subsidiary are recorded based on the functional currency of the entity. For MHH, the functional currency is the local currency which is the British Pound. Accordingly, the assets, liabilities and operations are translated, for consolidation purposes, from the local currency to the U.S. dollar reporting currency at period-end rates for assets and liabilities and generally at average rates for results of operations. The resulting unrealized gains or losses are reported as a component of accumulated other comprehensive income. Realized gains and losses resulting from foreign currency transactions are recorded in Other operating expenses in the consolidated income statements.

The following table shows the amount of revenue generated during the first quarter of 2012 and long-lived assets held at March 31, 2012 by geographical location (amounts in thousands):

	<b>Revenues</b>	<b>Long-Lived Assets</b>
United States	\$ 135,508	\$ 25,137
United Kingdom	4,638	1,232
<b>Total</b>	<b>\$ 140,146</b>	<b>\$ 26,369</b>

Revenues are attributed to countries based on the location of the related operations and long-lived assets consist of net property and equipment. Prior to the acquisition of MHH on January 16, 2012, all revenue generated and long-lived assets held related to the Company's United States operations.

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission (SEC) and, therefore, do not include all information and disclosures required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of the Company, however, the accompanying unaudited consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the Company's consolidated balance sheet as of March 31, 2012, its consolidated income statements and statements of comprehensive income for the three months ended March 31, 2012 and 2011, its consolidated statement of changes in stockholders' equity for the three months ended March 31, 2012, and its consolidated statements of cash flows for the three months ended March 31, 2012 and 2011. The consolidated income statements of the Company for the three months ended March 31, 2012 may not be indicative of future results. Certain reclassifications have been made to prior year amounts to conform to the current year presentation. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K, as filed for the year ended December 31, 2011.



**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****2. Finance Receivables, net:**

The Company accounts for its investment in finance receivables under the guidance of ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality (ASC 310-30). The Company acquires portfolios of accounts that have experienced deterioration of credit quality between origination and the Company's acquisition of the accounts. The amount paid for a portfolio reflects the Company's determination that it is probable the Company will be unable to collect all amounts due according to an account's contractual terms. At acquisition, the Company reviews the accounts to determine whether there is evidence of deterioration of credit quality since origination, and if it is probable that the Company will be unable to collect all amounts due according to the loan's contractual terms. If both conditions exist, the Company then determines whether each such account is to be accounted for individually or whether such accounts will be assembled into pools based on common risk characteristics. The Company considers expected prepayments and estimates the amount and timing of undiscounted expected principal, interest and other cash flows (expected at acquisition) for each acquired portfolio based on the Company's proprietary models, and the Company subsequently aggregates portfolios of accounts into pools. The Company determines the excess of the pool's scheduled contractual principal and contractual interest payments over all cash flows expected at acquisition as an amount that should not be accreted (nonaccretable difference). The remaining amount, representing the excess of the pool's cash flows expected to be collected over the amount paid, is accreted into income recognized on finance receivables over the remaining estimated life of the pool (accretable yield). ASC 310-30 requires that the excess of the contractual cash flows over expected cash flows, based on the Company's estimates derived from its proprietary collection models, not be recognized as an adjustment of revenue or expense or on the balance sheet.

Under ASC 310-30 static pools of accounts may be established. These pools are aggregated based on certain common risk criteria. Each static pool is recorded at cost, which includes certain direct costs of acquisition paid to third parties, and is accounted for as a single unit for the recognition of income, payments applied to principal and loss provision. Once a static pool is established for a calendar quarter, individual receivable accounts are not added to the pool (unless replaced by the seller) or removed from the pool (unless sold or returned to the seller). ASC 310-30, utilizing the interest method, initially freezes the yield, estimated when the accounts are purchased as the basis for subsequent impairment testing. The yield is estimated and periodically recalculated based on the timing and amount of anticipated cash flows using the Company's proprietary collection models. Income on finance receivables is accrued quarterly based on each static pool's effective yield. Significant increases in expected future cash flows may be recognized prospectively, through an upward adjustment of the yield, over a pool's remaining life. Any increase to the yield then becomes the new benchmark for impairment testing. Under ASC 310-30, rather than lowering the estimated yield if the collection estimates are not received or projected to be received, the carrying value of a pool would be written down to maintain the then current yield and is shown as a reduction in revenue in the consolidated income statements with a corresponding valuation allowance offsetting finance receivables, net, on the consolidated balance sheets. Quarterly cash flows greater than the interest accrual will reduce the carrying value of the static pool. This reduction in carrying value is defined as payments applied to principal (also referred to as principal amortization). Likewise, cash flows that are less than the interest accrual will accrete the carrying balance. Generally, the Company does not record accretion in the first six to twelve months of the estimated life of the pool; accordingly, the Company utilizes either the cost recovery method or cash method when necessary to prevent accretion as permitted by ASC 310-30. Under the cash method, revenue is recognized as it would be under the interest method up to the amount of cash collections. Under the cost recovery method, no revenue is recognized until the Company has fully collected the cost of the pool. A pool can become fully amortized (zero carrying balance on the balance sheet) while still generating cash collections. In this case, all cash collections are recognized as revenue when received. Additionally, the Company uses the cost recovery method when collections on a particular pool of accounts cannot be reasonably predicted. These cost recovery pools are not aggregated with other pools. Under the cost recovery method, no revenue is recognized until the Company has fully collected the cost of the pool, or until such time that the Company considers the collections to be probable and estimable and begins to recognize income based on the interest method as described above. At March 31, 2012 and 2011, the Company had unamortized purchased principal (purchase price) in pools accounted for under the cost recovery method of \$0.8 million and \$1.4 million, respectively.

**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

The Company establishes valuation allowances, if necessary, for acquired accounts subject to ASC 310-10. Valuation allowances are established only subsequent to acquisition of the accounts. At March 31, 2012 and 2011, the Company had a valuation allowance against its finance receivables of \$87.1 million and \$80.4 million, respectively. At December 31, 2011, the valuation allowance was \$86.6 million.

The Company implements the accounting for income recognized on finance receivables under ASC 310-30 as follows. The Company creates each accounting pool using its projections of estimated cash flows and expected economic life. The Company then computes the effective yield that fully amortizes the pool to the end of its expected economic life based on the current projections of estimated cash flows. As actual cash flow results are recorded, the Company balances those results to the data contained in its proprietary models to ensure accuracy, then reviews each pool watching for trends, actual performance versus projections and curve shape (a graphical depiction of the timing of cash flows), sometimes re-forecasting future cash flows utilizing the Company's statistical models. The review process is primarily performed by the Company's finance staff; however, the Company's operational and statistical staffs are also involved, providing updated statistical input and cash projections to the finance staff. To the extent there is overperformance, the Company will either increase the yield or release the allowance and consider increasing future cash projections, if persuasive evidence indicates that the overperformance is considered to be a significant betterment. If the overperformance is considered more of an acceleration of cash flows (a timing difference), the Company will adjust estimated future cash flows downward which effectively extends the amortization period, or take no action at all if the amortization period is reasonable and falls within the pool's expected economic life. In either case, yield may or may not be increased due to the time value of money (accelerated cash collections). To the extent there is underperformance, the Company will record an allowance if the underperformance is significant and will also consider revising estimated future cash flows based on current period information, or take no action if the pool's amortization period is reasonable and falls within the currently projected economic life.

Changes in finance receivables, net for the three months ended March 31, 2012 and 2011 were as follows (amounts in thousands):

	<b>Three Months Ended March 31, 2012</b>	<b>Three Months Ended March 31, 2011</b>
Balance at beginning of period	\$ 926,734	\$ 831,330
Acquisitions of finance receivables, net of buybacks	112,093	106,405
Foreign currency translation adjustment	185	
Cash collections	(217,996)	(166,717)
Income recognized on finance receivables, net	124,226	95,974
Cash collections applied to principal	(93,770)	(70,743)
Balance at end of period	\$ 945,242	\$ 866,992

At the time of acquisition, the life of each pool is generally estimated to be between 60 to 96 months based on projected amounts and timing of future cash collections using the proprietary models of the Company. Based upon current projections, cash collections applied to principal on finance receivables as of March 31, 2012 are estimated to be as follows for the twelve months in the periods ending (amounts in thousands):

March, 31, 2013	\$ 323,163
March, 31, 2014	268,030
March, 31, 2015	192,704

Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

March, 31, 2016	122,087
March, 31, 2017	38,862
March, 31, 2018	396
	\$ 945,242



**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

During the three months ended March 31, 2012 and 2011, the Company purchased approximately \$1.46 billion and \$1.49 billion, respectively, in face value of charged-off consumer receivables. At March 31, 2012, the estimated remaining collections ( ERC ) on the receivables purchased in the three months ended March 31, 2012 and 2011, were \$203.6 million and \$174.3 million, respectively.

Accretable yield represents the amount of income recognized on finance receivables the Company can expect to generate over the remaining life of its existing portfolios based on estimated future cash flows as of the balance sheet date. Additions represent the original expected accretable yield to be earned by the Company based on its proprietary buying models. Reclassifications from nonaccretable difference to accretable yield primarily result from the Company's increase in its estimate of future cash flows. Reclassifications to nonaccretable difference from accretable yield result from the Company's decrease in its estimates of future cash flows and allowance charges that exceed the Company's increase in its estimate of future cash flows. Changes in accretable yield for the three months ended March 31, 2012 and 2011 were as follows (amounts in thousands):

	<b>Three Months Ended March 31, 2012</b>	<b>Three Months Ended March 31, 2011</b>
Balance at beginning of period	\$ 1,026,614	\$ 892,188
Income recognized on finance receivables, net	(124,226)	(95,974)
Additions	99,552	109,502
Reclassifications from nonaccretable difference	86,638	20,562
Foreign currency translation adjustment	174	
Balance at end of period	\$ 1,088,752	\$ 926,278

A valuation allowance is recorded for significant decreases in expected cash flows or change in timing of cash flows which would otherwise require a reduction in the stated yield on a pool of accounts. In any given period, the Company may be required to record valuation allowances due to pools of receivables underperforming expectations. Factors that may contribute to the recording of valuation allowances may include both internal as well as external factors. External factors which may have an impact on the collectability, and subsequently to the overall profitability of purchased pools of defaulted consumer receivables would include: new laws or regulations relating to collections, new interpretations of existing laws or regulations, and the overall condition of the economy. Internal factors which may have an impact on the collectability, and subsequently the overall profitability of purchased pools of defaulted consumer receivables would include: necessary revisions to initial and post-acquisition scoring and modeling estimates, non-optimal operational activities (which relate to the collection and movement of accounts on both the collection floor of the Company and external channels), as well as decreases in productivity related to turnover and tenure of the Company's collection staff.

The following is a summary of activity within the Company's valuation allowance account, all of which relates to loans acquired with deteriorated credit quality, for the three months ended March 31, 2012 and 2011 (amounts in thousands):

	<b>Core Portfolio (1)</b>	<b>Three Months Ended March 31, 2012 Purchased Bankruptcy Portfolio (2)</b>	<b>Total</b>
Valuation allowance - finance receivables:			
Beginning balance	\$ 76,580	\$ 9,991	\$ 86,571

Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

Allowance charges	1,350	1,100	2,450
Reversal of previous recorded allowance charges	(1,820)	(136)	(1,956)
Net allowance charge	(470)	964	494
Ending balance	\$ 76,110	\$ 10,955	\$ 87,065
Finance receivables, net <sup>(3)</sup> :	\$ 453,709	\$ 486,137	\$ 939,846

**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

	<b>Three Months Ended March 31, 2011</b>		
	Core Portfolio (1)	Purchased Bankruptcy Portfolio (2)	Total
<b>Valuation allowance - finance receivables:</b>			
Beginning balance	\$ 70,030	\$ 6,377	\$ 76,407
Allowance charges	2,850	2,450	5,300
Reversal of previous recorded allowance charges	(1,050)	(210)	(1,260)
<b>Net allowance charge</b>	<b>1,800</b>	<b>2,240</b>	<b>4,040</b>
Ending balance	\$ 71,830	\$ 8,617	\$ 80,447
<b>Finance receivables, net:</b>	<b>\$ 428,091</b>	<b>\$ 438,901</b>	<b>\$ 866,992</b>

- (1) Core accounts or portfolios refer to accounts or portfolios that are defaulted consumer receivables and are not in a bankrupt status upon purchase. These accounts are aggregated separately from purchased bankruptcy accounts.
- (2) Purchased bankruptcy accounts or portfolios refer to accounts or portfolios that are in bankruptcy status when purchased, and as such, are purchased as a pool of bankrupt accounts.
- (3) At March 31, 2012, the MHH finance receivables balance was \$5.4 million against which there was no valuation allowance recorded; therefore it is not included in this roll-forward.

**3. Accounts Receivable, net:**

Accounts receivable are recorded at the invoiced amount and do not bear interest. Amounts collected on accounts receivable are included in net cash provided by operating activities in the consolidated statements of cash flows. The Company maintains an allowance for doubtful accounts for estimated losses inherent in its accounts receivable portfolio. In establishing the required allowance, management considers historical losses adjusted to take into account current market conditions and its customers' financial condition, the amount of receivables in dispute, the current receivables aging, and current payment patterns. The Company reviews its allowance for doubtful accounts monthly. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The balance of the allowance for doubtful accounts at both March 31, 2012 and December 31, 2011 was \$2.1 million. The Company does not have any off balance sheet credit exposure related to its customers.

**4. Line of Credit:**

On December 20, 2010, the Company entered into a credit agreement with Bank of America, N.A., as administrative agent, and a syndicate of lenders named therein (the Credit Agreement). Under the terms of the Credit Agreement, the credit facility includes an aggregate principal amount available of \$407.5 million (subject to the borrowing base and applicable debt covenants) which consists of a \$50 million fixed rate loan that matures on May 4, 2012, which was transferred from the Company's then existing credit agreement, and a \$357.5 million revolving credit facility that matures on December 20, 2014. The revolving credit facility will be automatically increased by \$50 million upon the maturity and repayment of the fixed rate loan. The fixed rate loan bears interest at a rate of 6.8% per annum, payable monthly in arrears. The revolving loans accrue interest, at the option of the Company, at either the base rate plus 1.75% per annum or the Eurodollar rate (as defined in the Credit Agreement) for the applicable term plus 2.75% per annum. The base rate is the highest of (a) the Federal Funds Rate plus 0.50%, (b) Bank of

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

America's prime rate, and (c) the Eurodollar rate plus 1.00%. Interest is payable on base rate loans quarterly in arrears and on Eurodollar loans in arrears on the last day of each interest period or, if such interest period exceeds three months, every three months. The Company's revolving credit facility includes a \$20 million swingline loan sublimit and a \$20 million letter of credit sublimit. It also contains an accordion loan feature that allows the Company to request an increase of up to \$142.5 million in the amount available for borrowing under the revolving credit facility, whether from existing or new lenders, subject to terms of the Credit Agreement. No existing lender is obligated to increase its commitment. On April 20, 2012, the Company closed a series of

**Table of Contents**

**PORTFOLIO RECOVERY ASSOCIATES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

transactions to exercise a portion of the accordion loan feature of its existing credit facility with its administrative agent and its syndicate of lenders, thereby increasing the lenders' commitments by \$50,950,000, resulting in \$458,450,000 aggregate principal amount available under the Company's line of credit. The Company's existing lenders under the Credit Agreement provided \$40,950,000 of this increase, and \$10,000,000 was provided by a new lender, which is now a party to the Credit Agreement. The Company may request additional increases of up to \$91,550,000 under its credit facility. The Credit Agreement is secured by a first priority lien on substantially all of the Company's assets. The Credit Agreement contains restrictive covenants and events of default including the following:

borrowings may not exceed 30% of the ERC of all its domestic eligible asset pools plus 75% of its eligible accounts receivable;

the consolidated leverage ratio (as defined in the Credit Agreement) cannot exceed 2.0 to 1.0 as of the end of any fiscal quarter;

consolidated Tangible Net Worth (as defined in the Credit Agreement) must equal or exceed \$309,452,000 plus 50% of positive consolidated net income for each fiscal quarter beginning December 31, 2010, plus 50% of the net proceeds of any equity offering;

capital expenditures during any fiscal year cannot exceed \$20 million;

cash dividends and distributions during any fiscal year cannot exceed \$20 million;

stock repurchases during the term of the agreement cannot exceed \$100 million;

permitted acquisitions (as defined in the Credit Agreement) during any fiscal year cannot exceed \$100 million;

the Company must maintain positive consolidated income from operations (as defined in the Credit Agreement) during any fiscal quarter; and

restrictions on changes in control.

The revolving credit facility also bears an unused commitment fee of 0.375% per annum, payable quarterly in arrears.

The Company had \$265.0 million and \$220.0 million of borrowings outstanding on its credit facility as of March 31, 2012 and December 31, 2011, respectively, of which \$50 million represented borrowing under the non-revolving fixed rate loan at both dates. At March 31, 2012, the Company's borrowings under its revolving credit facility consisted of 30-day Eurodollar rate loans with a weighted average annual interest rate equal to 2.99%.

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

The Company was in compliance with all covenants of its credit facility as of March 31, 2012 and December 31, 2011.

### **5. Long-Term Debt:**

On February 6, 2009, the Company entered into a commercial loan agreement to finance computer software and equipment purchases in the amount of approximately \$2.0 million. The loan was collateralized by the related computer software and equipment. The loan was a three year loan with a fixed rate of 4.78% with monthly installments, including interest, of \$60,823 beginning on March 31, 2009, and it matured on February 28, 2012.

**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

On December 15, 2010, the Company entered into a commercial loan agreement to finance computer software and equipment purchases in the amount of approximately \$1.6 million. The loan is collateralized by the related computer software and equipment. The loan is a three year loan with a fixed rate of 3.69% with monthly installments, including interest, of \$46,108 beginning on January 15, 2011, and it matures on December 15, 2013.

**6. Property and Equipment, net:**

Property and equipment, at cost, consisted of the following as of the dates indicated (amounts in thousands):

	<b>March 31, 2012</b>	<b>December 31, 2011</b>
Software	\$ 27,126	\$ 25,252
Computer equipment	13,036	12,221
Furniture and fixtures	6,748	6,501
Equipment	8,213	7,798
Leasehold improvements	6,418	6,117
Building and improvements	6,999	6,987
Land	1,269	1,269
Accumulated depreciation and amortization	(43,440)	(40,418)
<b>Property and equipment, net</b>	<b>\$ 26,369</b>	<b>\$ 25,727</b>

Depreciation and amortization expense relating to property and equipment, for the three months ended March 31, 2012 and 2011, was \$2.2 million and \$2.0 million, respectively.

The Company, in accordance with the guidance of FASB ASC Topic 350-40 Internal-Use Software (ASC 350-40), capitalizes qualifying computer software costs incurred during the application development stage and amortizes them over their estimated useful life of three to seven years on a straight-line basis beginning when the project is completed. Costs associated with preliminary project stage activities, training, maintenance and all other post implementation stage activities are expensed as incurred. The Company's policy provides for the capitalization of certain direct payroll costs for employees who are directly associated with internal use computer software projects, as well as external direct costs of services associated with developing or obtaining internal use software. Capitalizable personnel costs are limited to the time directly spent on such projects. As of March 31, 2012 and December 31, 2011, the Company has incurred and capitalized approximately \$6.5 million and \$6.1 million, respectively, of these direct payroll costs and external direct costs related to software developed for internal use. Of these costs, at March 31, 2012 and December 31, 2011, approximately \$1.1 million and \$1.3 million, respectively, is for projects that are in the development stage and, therefore are a component of Other Assets. Once the projects are completed, the costs will be transferred to Software and amortized over their estimated useful life of three to seven years. Amortization expense for the three months ended March 31, 2012 and 2011, was approximately \$0.3 million and \$0.2 million, respectively. The remaining unamortized costs relating to internally developed software at March 31, 2012 and 2011 were approximately \$3.7 million and \$3.0 million, respectively. The amount at December 31, 2011 was approximately \$3.3 million.

**7. Redeemable Noncontrolling Interest:**

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

In accordance with ASC 810, the Company has consolidated all financial statement accounts of Claims Compensation Bureau, LLC ( CCB ) in its consolidated balance sheets as of March 31, 2012 and December 31, 2011, and its consolidated income statements for the three months ended March 31, 2012 and 2011. The redeemable noncontrolling interest amount is separately stated on the consolidated balance sheets and represents the 38% interest in CCB not owned by the Company. In addition, net income/loss attributable to the noncontrolling interest is stated separately in the consolidated income statements for the three months ended March 31, 2012 and 2011.



**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

The Company applies the provisions of FASB ASC Topic 480-10-S99 Distinguishing Liabilities from Equity (ASC 480-10-S99), which provides guidance on the accounting for equity securities that are subject to mandatory redemption requirements or whose redemption is outside the control of the issuer. The noncontrolling interest put arrangement is accounted for under ASC 480-10-S99, as redemption under the put arrangement is outside the control of the Company. As such, the redeemable noncontrolling interest is recorded outside of permanent equity. The Company measures the redeemable noncontrolling interest at the greater of its ASC 480-10-S99 measurement amount (estimated redemption value of the put option embedded in the noncontrolling interest) or its measurement amount under the guidance of ASC 810. The ASC 810 measurement amount includes adjustments for the noncontrolling interest's pro-rata share of earnings, losses and distributions, pursuant to the limited liability company agreement of CCB. Adjustments to the measurement amount are recorded to stockholders' equity. The Company used a present value calculation to estimate the redemption value of the put option as of the reporting date. As such, for the three months ended March 31, 2012 and 2011, the Company increased the redeemable noncontrolling interest by \$1.2 million and \$1.0 million, respectively, with a corresponding reduction of stockholders' equity. If material, the Company adjusts the numerator of earnings per share calculations for the current period change in the excess of the noncontrolling interest's ASC 480-10-S99 measurement amount over the greater of its ASC 810 measurement amount or the estimated fair value of the noncontrolling interest. Although the noncontrolling interest was redeemable by the Company as of the reporting date, it was not yet redeemable by the holder of the put option. The maximum estimated redemption value of the noncontrolling interest, as if it were currently redeemable by the holder of the put option under the terms of the put arrangement, was \$22.8 million as of March 31, 2012 and December 31, 2011.

The following table represents the changes in the redeemable noncontrolling interest for the three months ended March 31, 2012 and 2011 (amounts in thousands):

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Balance at beginning of period	\$ 17,831	\$ 14,449
Net (loss)/income attributable to redeemable noncontrolling interest	(273)	588
Distributions paid or payable		(769)
Adjustment of the noncontrolling interest measurement amount	1,225	985
Balance at end of period	\$ 18,783	\$ 15,253

In accordance with the limited liability company agreement of CCB, distributions due to the members of the LLC are accrued each quarter and are payable as soon as reasonably possible subsequent to each quarter end.

**8. Goodwill and Intangible Assets, net:**

In connection with the Company's previous business acquisitions, the Company purchased certain tangible and intangible assets. Intangible assets purchased included client and customer relationships, non-compete agreements, trademarks and goodwill. Pursuant to ASC 350, goodwill is not amortized but rather is reviewed at least annually for impairment. During the fourth quarter of 2011, the Company underwent its annual review of goodwill. Based upon the results of this review, which was conducted as of October 1, 2011, no impairment charges to goodwill or the other intangible assets were necessary as of the date of this review. The Company believes that nothing has occurred since the review was performed through March 31, 2012 that would indicate a triggering event and thereby necessitate an impairment charge to goodwill or the other intangible assets. Accordingly, there were no impairment losses during the three months ended March 31, 2012 and 2011. The Company expects to perform its next annual goodwill review during the fourth quarter of 2012. At March 31, 2012 and December 31, 2011, the carrying value of goodwill was \$97.5 million and \$61.7 million, respectively. See Note 9 for more information. The following table represents the changes in

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

goodwill for the three months ended March 31, 2012 and 2011 (amounts in thousands):

	<b>Three Months Ended March 31, 2012</b>	<b>Three Months Ended March 31, 2011</b>
Balance at beginning of period	\$ 61,678	\$ 61,678
Acquisition of MHH	34,270	
Foreign currency translation adjustment	1,532	
Balance at end of period	\$ 97,480	\$ 61,678

**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

Intangible assets, excluding goodwill, consist of the following at March 31, 2012 and December 31, 2011 (amounts in thousands):

	March 31, 2012		December 31, 2011	
	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Client and customer relationships	\$ 43,086	\$ 19,077	\$ 30,777	\$ 17,950
Non-compete agreements	3,742	2,971	3,103	2,771
Trademarks	3,619	1,220	2,500	1,063
Total	\$ 50,447	\$ 23,268	\$ 36,380	\$ 21,784

Increases in the gross amounts of intangible assets during the three months ended March 31, 2012 relate to the purchase of MHH on January 16, 2012. The combined original weighted average amortization period related to the acquired intangible assets of MHH is 13.4 years. In accordance with ASC 350, the Company is amortizing the intangible assets over the estimated useful lives as indicated:

	Acquisition Date	Customer Relationships	Non-Compete Agreements	Trademarks
MHH	January 16, 2012	15 years	1 year	3 years

Total amortization expense for the three months ended March 31, 2012 and 2011 was \$1.5 million and \$1.3 million, respectively. The Company reviews these intangible assets at least annually for impairment.

**9. Business Acquisition:**

On January 16, 2012, the Company acquired 100% of the equity interest in MHH. The transaction was completed in cash at a price of £33.5 million (approximately \$51.3 million). The Company financed the acquisition with borrowings under its existing line of credit. Based in Kilmarnock, Scotland, MHH employs approximately 170 people and offers outsourced and contingent consumer debt recovery on behalf of banks, credit providers and debt purchasers, as well as distressed and dormant niche portfolio purchasing. The acquisition of MHH expands the Company's presence into new geographical markets outside the United States, further diversifying its revenues and available service offerings.

The Company accounted for this purchase in accordance with ASC Topic 805, Business Combinations. Under this guidance, an entity is required to recognize the assets acquired, liabilities assumed and the consideration given at their fair value on the acquisition date. The following tables summarize the fair value of the consideration given for MHH, as well as the fair value of the assets acquired and liabilities assumed as of the January 16, 2012 acquisition date.

**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

Recognized amounts of identifiable assets and liabilities are as follows (amounts in thousands):

Purchase price	\$ 51,258
Cash	(2,606)
Finance receivables, net	(3,906)
Accounts receivable	(2,038)
Prepaid expenses (included in other assets)	(330)
Customer relationships	(11,782)
Non-compete agreements	(612)
Trademarks	(1,071)
Fixed assets	(814)
Accounts payable	3,501
Accrued expenses	1,461
Income tax payable	1,209
Goodwill	 \$ 34,270

The Company is evaluating the purchase price allocations and at the time of the filing of this Form 10-Q, the valuation has not been completed. However, the Company has recorded provisional amounts for the assets acquired in its consolidated financial statements and will adjust the allocations relative to the fair value of the assets, as necessary, during the remainder of the one-year measurement period.

**10. Share-Based Compensation:**

The Company follows the provisions of FASB ASC Topic 718 Compensation-Stock Compensation ( ASC 718 ) with respect to its stock plan. As of March 31, 2012, total future compensation costs related to nonvested awards of nonvested shares (not including nonvested shares granted under the Long-Term Incentive Program ( LTI )) is estimated to be \$4.8 million with a weighted average remaining life for all nonvested shares of 2.2 years (not including nonvested shares granted under the LTI Programs). As of March 31, 2012, there are no future compensation costs related to stock options and there are no remaining vested stock options to be exercised. Based upon historical data, the Company used an annual forfeiture rate of 14% for stock options and 15-40% for nonvested shares for most of the employee grants. Grants made to key employees and directors of the Company were assumed to have no forfeiture rates associated with them due to the historically low turnover among this group.

Total share-based compensation expense was approximately \$2.3 million and \$2.6 million for the three months ended March 31, 2012 and 2011, respectively. Tax benefits resulting from tax deductions in excess of share-based compensation expense recognized under the provisions of ASC 718 (windfall tax benefits) are credited to additional paid-in capital in the Company's Consolidated Balance Sheets. Realized tax shortfalls, if any, are first offset against the cumulative balance of windfall tax benefits, if any, and then charged directly to income tax expense. The total tax benefit realized from share-based compensation was approximately \$2.7 million and \$1.0 million for the three months ended March 31, 2012 and 2011, respectively.

***Nonvested Shares***

With the exception of the awards made pursuant to the LTI Program and a few employee and director grants, the nonvested shares generally vest ratably over three to five years and are expensed over their vesting period.



**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

The following summarizes all nonvested share transactions (excluding shares granted under the LTI Programs) from December 31, 2010 through March 31, 2012 (amounts in thousands, except per share amounts):

	Nonvested Shares Outstanding	Weighted-Average Price at Grant Date
December 31, 2010	91	\$ 47.89
Granted	48	76.59
Vested	(53)	55.97
Cancelled	(5)	50.34
December 31, 2011	81	59.31
Granted	43	62.19
Vested	(22)	56.62
March 31, 2012	102	\$ 61.09

The total grant date fair value of shares vested during the three months ended March 31, 2012 and 2011 was approximately \$1.2 million and \$1.7 million, respectively.

***Long-Term Incentive Programs***

Pursuant to the Amended Plan, on January 20, 2009, January 14, 2010, January 14, 2011 and January 9, 2012, the Compensation Committee approved the grant of 108,720, 53,656, 73,914, and 65,647 performance and market based nonvested shares, respectively. All shares granted under the LTI Programs were granted to key employees of the Company. The 2009 grant was performance based and cliff vested after the requisite service period if certain financial goals were met. The goals were based upon diluted earnings per share (EPS) totals for 2009, the return on owners' equity for the three year period beginning on January 1, 2009 and ending December 31, 2011, and the relative total stockholder return as compared to a peer group for the same three year period. The Company expensed the nonvested share grant over the requisite service period of two to three years beginning on January 1, 2009. The EPS component of the 2009 plan was not achieved and therefore no compensation expense was recognized relative to this component. The return on owners' equity and relative total stockholder return components have been achieved at 98% and 145%, respectively, and the awards were paid to participants during the first quarter of 2012.

The 2010 grant is performance based and cliff vests after the requisite service period of two to three years if certain financial goals are met. The goals are based upon diluted EPS totals for 2010, the return on owners' equity for the three year period beginning on January 1, 2010 and ending December 31, 2012, and the relative total stockholder return as compared to a peer group for the same three year period. For each component, the number of shares vested can double if the financial goals are exceeded and no shares will vest if the financial goals are not met. The EPS component of the 2010 plan was achieved at 190% and these shares vested at 50% on December 31, 2011 and the remaining 50% will vest on December 31, 2012. The Company is expensing the nonvested share grant over the requisite service period of two to three years beginning on January 1, 2010. If the Company believes that the number of shares granted will be more or less than originally projected, an adjustment to the expense will be made at that time based on the probable outcome.

The 2011 grant is performance based and cliff vests after the requisite service period of two to three years if certain financial goals are met. The goals are based upon the Company's earnings before interest, taxes, depreciation and amortization (EBITDA) for 2011, the return on owners' equity for the three year period beginning on January 1, 2011 and ending December 31, 2013, and the relative total stockholder return as compared to a peer group for the same three year period. For each component, the number of shares vested can double if the financial goals are exceeded and no shares will vest if the financial goals are not met. The Company is expensing the nonvested share grant over the requisite

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

service period of two to three years beginning on January 1, 2011. If the Company believes that the number of shares granted will be more or less than originally projected, an adjustment to the expense will be made at that time based on the probable outcome. The EBITDA component of the 2011 plan was achieved at 200% and these shares will vest 50% on December 31, 2012 and December 31, 2013.

**Table of Contents**

**PORTFOLIO RECOVERY ASSOCIATES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

The 2012 grant is performance based and cliff vests after the requisite service period of two to three years if certain financial goals are met. The goals are based upon the Company's EBITDA for 2012, the return on owners' equity for the three year period beginning on January 1, 2012 and ending December 31, 2014, and the relative total stockholder return as compared to a peer group for the same three year period. For each component, the number of shares vested can double if the financial goals are exceeded and no shares will vest if the financial goals are not met. The Company is expensing the nonvested share grant over the requisite service period of two to three years beginning on January 1, 2012. If the Company believes that the number of shares granted will be more or less than originally projected, an adjustment to the expense will be made at that time based on the probable outcome.

At March 31, 2012, total future compensation costs, assuming the current estimated levels are achieved, related to nonvested share awards granted under the 2010, 2011 and 2012 LTI Programs are estimated to be approximately \$7.9 million. The Company assumed a 7.5% forfeiture rate for this grant and the remaining shares have a weighted average life of 1.66 years at March 31, 2012.

**11. Income Taxes:**

The Company follows the guidance of FASB ASC Topic 740 Income Taxes (ASC 740) as it relates to the provision for income taxes and uncertainty in income taxes. The guidance prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. There were no unrecognized tax benefits at both March 31, 2012 and 2011.

The Company was notified on June 21, 2007 that it was being examined by the U.S. Internal Revenue Service (the IRS) for the 2005 calendar year. The IRS concluded the audit and on March 19, 2009 issued Form 4549-A, Income Tax Examination Changes, for tax years ended December 31, 2007, 2006 and 2005. The IRS has asserted that cost recovery for tax revenue recognition does not clearly reflect taxable income and that unused line fees paid on credit facilities should be capitalized and amortized rather than taken as a current deduction. The Company believes it has sufficient support for the technical merits of its positions and that it is more likely than not these positions will ultimately be sustained; therefore, a reserve for uncertain tax positions is not necessary. On April 22, 2009, the Company filed a formal protest of the findings contained in the examination report prepared by the IRS. On August 26, 2011, the IRS issued a Notice of Deficiency for the tax years ended December 31, 2007, 2006, and 2005. There are three possible courses of action in response to a Notice of Deficiency: (1) pay the assessment and close the audit, (2) pay the assessed tax and interest and then file a refund suit in United States District Court, or (3) file a petition in United States Tax Court, which does not require a payment up front of the assessed tax and interest. The Company subsequently filed a petition in United States Tax Court to which the IRS responded on January 12, 2012. If the Company is unsuccessful in tax court, it can appeal to the federal Circuit Court of Appeals. Payment of the assessed taxes and interest could have an adverse affect on the Company's financial condition, be material to the Company's results of operations, and possibly require additional financing from other sources. In accordance with the U.S. Internal Revenue Code of 1986, as amended (the Internal Revenue Code), underpayments of federal tax accrue interest, compounded daily, at the applicable federal short term rate plus three percentage points. An additional two percentage points applies to large corporate underpayments of \$100,000 or more to periods after the applicable date as defined in the Internal Revenue Code. The Company files taxes in multiple state jurisdictions; therefore, any underpayment of state tax will accrue interest in accordance with the respective state statute. In 2011, the IRS expanded the audit to include the tax years ended December 31, 2010, 2009 and 2008.

At March 31, 2012, the tax years subject to examination by the major taxing jurisdictions, including the IRS, are 2003, 2005 and subsequent years. The 2003 tax year remains open to examination because of a net operating loss that originated in that year but was not fully utilized until the 2005 tax year. The examination periods for the 2007, 2006 and 2005 tax years were extended through December 31, 2011; however, because the IRS issued the Notice of Deficiency prior to December 31, 2011, the period for assessment is suspended until a decision of the Tax Court becomes final.



**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

ASC 740 requires the recognition of interest, if the tax law would require interest to be paid on the underpayment of taxes, and recognition of penalties, if a tax position does not meet the minimum statutory threshold to avoid payment of penalties. No interest or penalties were accrued or reversed in the first three months ended March 31, 2012 or 2011.

**12. Earnings per Share:**

Basic EPS are computed by dividing net income available to common stockholders of PRA Inc. by weighted average common shares outstanding. Diluted EPS are computed using the same components as basic EPS with the denominator adjusted for the dilutive effect of stock options and nonvested share awards. Share-based awards that are contingent upon the attainment of performance goals are not included in the computation of diluted EPS until the performance goals have been attained. The dilutive effect of stock options and nonvested shares is computed using the treasury stock method, which assumes any proceeds that could be obtained upon the exercise of stock options and vesting of nonvested shares would be used to purchase common shares at the average market price for the period. The assumed proceeds include the windfall tax benefit that would be received upon assumed exercise. The following tables provide a reconciliation between the computation of basic EPS and diluted EPS for the three months ended March 31, 2012 and 2011 (amounts in thousands, except per share amounts):

	2012		For the three months ended March 31, 2011			
	Net Income attributable to Portfolio Recovery Associates, Inc.	Weighted Average Common Shares	EPS	Net Income attributable to Portfolio Recovery Associates, Inc.	Weighted Average Common Shares	EPS
Basic EPS	\$ 25,462	17,196	\$ 1.48	\$ 23,121	17,092	\$ 1.35
Dilutive effect of nonvested share awards		71			107	
Diluted EPS	\$ 25,462	17,267	\$ 1.47	\$ 23,121	17,199	\$ 1.34

There were no antidilutive options outstanding for the three months ended March 31, 2012 and 2011.

**13. Commitments and Contingencies:***Employment Agreements:*

The Company has employment agreements, most of which expire on December 31, 2014, with all of its executive officers and with several members of its senior management group. Such agreements provide for base salary payments as well as bonuses which are based on the attainment of specific management goals. Future compensation under these agreements is approximately \$15.7 million. The agreements also contain confidentiality and non-compete provisions.

*Leases:*

The Company is party to various operating and capital leases with respect to its facilities and equipment. For further discussion of these leases please refer to the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K, as filed for the year ended December 31, 2011.

*Forward Flow Agreements:*

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

The Company is party to several forward flow agreements that allow for the purchase of defaulted consumer receivables at pre-established prices. The maximum remaining amount to be purchased under forward flow agreements at March 31, 2012 is approximately \$212.5 million.

**Table of Contents**

**PORTFOLIO RECOVERY ASSOCIATES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

*Redeemable Noncontrolling Interest:*

In connection with the Company's acquisition of 62% of the membership units of CCB on March 15, 2010, the Company acquired the right to purchase the remaining 38% of the membership units of CCB not held by the Company at a predetermined price within the next four years. Also, the owners of the noncontrolling interest can require the Company to purchase their respective interest during the period beginning on March 1, 2012 and ending on February 28, 2018. While the actual amount or timing of any future payment is unknown at this time, the maximum amount of consideration to be paid for the 38% interest is \$22.8 million.

*Litigation:*

The Company is from time to time subject to routine legal claims and proceedings, most of which are incidental to the ordinary course of its business. The Company initiates lawsuits against customers and is occasionally countersued by them in such actions. Also, customers, either individually, as members of a class action, or through a governmental entity on behalf of customers, may initiate litigation against the Company in which they allege that the Company has violated a state or federal law in the process of collecting on an account. From time to time, other types of lawsuits are brought against the Company.

The Company accrues for potential liability arising from legal proceedings when it is probable that such liability has been incurred and the amount of the loss can be reasonably estimated. This determination is based upon currently available information for those proceedings in which the Company is involved, taking into account the Company's best estimate of such losses for those cases for which such estimates can be made. The Company's estimate involves significant judgment, given the varying stages of the proceedings (including the fact that many of them are currently in preliminary stages), the number of unresolved issues in many of the proceedings (including issues regarding class certification and the scope of many of the claims), and the related uncertainty of the potential outcomes of these proceedings. In making determinations of the likely outcome of the pending litigation disclosed below, the Company considers many factors, including, but not limited to, the nature of the claims, the Company's experience with similar types of claims, the jurisdiction in which the matter is filed, input from outside legal counsel, the likelihood of resolving the matter through alternative mechanisms, the matter's current status and the damages sought or demands made. Accordingly, the Company's estimate will change from time to time, and actual losses may be more than the current estimate.

The Company believes, based upon its current knowledge and after consultation with counsel, that the legal proceedings currently pending against it should not, either individually or in the aggregate, have a material adverse impact on the Company's financial condition. However, it is possible, in light of the uncertainties involved in such proceedings or due to unexpected future developments, that an unfavorable resolution of a legal proceeding or claim could occur which may be material to the Company's results of operations for a particular period. The matters described below fall outside of the normal parameters of the Company's routine legal proceedings.

The Company has been named as defendant in the following five putative class action cases, each of which alleges that it violated the Telephone Consumer Protection Act (TCPA) by calling consumers' cellular telephones without their prior express consent: Allen v. Portfolio Recovery Associates, Inc., Case No. 10-cv-2658, instituted in the United States District Court for the Southern District of California on December 23, 2010; Meyer v. Portfolio Recovery Associates, LLC, Case No. 37-2011-00083047, instituted in the Superior Court of California, San Diego County on January 3, 2011; Frydman v. Portfolio Recovery Associates, LLC, Case No. 11-cv-524, instituted in the United States District Court for the Northern District of Illinois on January 31, 2011; Bartlett v. Portfolio Recovery Associates, LLC, Case No. 11-cv-0624, instituted in the United States District Court for the Northern District of Georgia on March 1, 2011; and Harvey v. Portfolio Recovery Associates, LLC, Case No. 11-cv-00582, instituted in the United States District Court for the Middle District of Florida on April 8, 2011. Each of the foregoing complaints allege violations of the TCPA, and seek damages, injunctive relief and attorneys' fees. On December 21, 2011, the United States District Panel on Multi-District Litigation entered an order transferring these matters into one consolidated proceeding in the United States District Court for the Southern District of California, case No. 11-md-02295.

**Table of Contents****PORTFOLIO RECOVERY ASSOCIATES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

These matters have only recently been consolidated, no litigation has proceeded on whether or not to certify a class or on the merits of the allegations, and no demand has been made. Further, even if a class is ultimately certified, further discovery must take place in order to determine its size. Therefore; any potential loss for these and other similar TCPA matters, cannot be estimated at this time; however, in the event that a class is eventually certified and it neither settles nor prevails on these matters, our damages, when aggregated, could potentially fall within a range which could be in excess of its established liability, and could be material to the Company's financial condition, results of operations or cash flows for any particular reporting period.

Excluding the above TCPA matter and other matters, the high end of the range of potential litigation losses in excess of the Company's established liability is currently estimated by management to be less than \$1,000,000. Notwithstanding our attempt to estimate a range of possible losses in excess of the Company's established liability based on current information, actual future losses may exceed both the Company's established liability and the range of potential litigation losses disclosed in this item.

**14. Fair Value Measurements and Disclosures:**

In accordance with the disclosure requirements of FASB ASC Topic 825, Financial Instruments (ASC 825), the table below summarizes fair value estimates for the Company's financial instruments. The total of the fair value calculations presented does not represent, and should not be construed to represent, the underlying value of the Company. The carrying amounts in the table are recorded in the consolidated balance sheet under the indicated captions (amounts in thousands):

	March 31, 2012		December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 28,068	\$ 28,068	\$ 26,697	\$ 26,697
Finance receivables, net	945,242	1,297,822	926,734	1,269,277
<b>Financial liabilities:</b>				
Line of credit	\$ 265,000	\$ 265,000	\$ 220,000	\$ 220,000
Long-term debt	936	936	1,246	1,246

As of March 31, 2012, and December 31, 2011, the Company did not account for any financial assets or financial liabilities at fair value. As defined by FASB ASC Topic 820, Fair Value Measurements and Disclosures (ASC 820), fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 also requires the consideration of differing levels of inputs in the determination of fair values. Those levels of input are summarized as follows:

Level 1 Quoted prices in active markets for identical assets and liabilities.

Level 2 Observable inputs other than Level 1 quoted prices, such as quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

Level 3 Unobservable inputs that are supported by little or no market activity. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques as well as instruments for which the determination of fair value requires significant management judgment or estimation.

---

**Table of Contents**

**PORTFOLIO RECOVERY ASSOCIATES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

Disclosure of the estimated fair values of financial instruments often requires the use of estimates. The Company uses the following methods and assumptions to estimate the fair value of financial instruments:

**Cash and cash equivalents:** The carrying amount approximates fair value and quoted prices for identical assets can be found in active markets. Accordingly, the Company estimates the fair value of cash and cash equivalents using level 1 inputs.

**Finance receivables, net:** The Company records purchased receivables at cost, which represents a significant discount from the contractual receivable balances due. The Company computed the estimated fair value of these receivables using proprietary pricing models that the Company utilizes to make portfolio purchase decisions. Accordingly, the Company's fair value estimates use level 3 inputs as there is little observable market data available and management is required to use significant judgment in its estimates.

**Line of credit:** The carrying amount approximates fair value due to the short-term nature of the interest rate periods and the observable quoted prices for similar instruments in active markets. Accordingly, the Company uses Level 2 inputs for its fair value estimates.

**Long-term debt:** The carrying amount approximates fair value, as the interest rates approximate the rate currently offered to the Company for similar debt instruments of comparable maturities by the Company's bankers. Accordingly, the Company uses Level 2 inputs for its fair value estimates.

**15. Stockholders' Equity:**

On February 2, 2012, the Board of Directors of the Company authorized a share repurchase program of up to \$100 million of the Company's outstanding shares of common stock. The program is administered by a special committee of the Company's Board of Directors. Repurchases would depend on prevailing market conditions and other factors. The repurchase program may be suspended or discontinued at any time. During the first quarter of 2012, the Company repurchased and retired 30,600 shares at an average price of \$68.02 (including acquisition costs).

**16. Recent Accounting Pronouncements:**

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. The amendments in ASU 2011-04 generally represent clarification of Topic 820, but also include instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and International Financial Reporting Standards (IFRS). The provisions of ASU 2011-04 are effective prospectively for interim and annual periods beginning after December 15, 2011. Early adoption is prohibited. The Company adopted ASU 2011-04 on January 1, 2012, and has included the required disclosures in its notes to its consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220) to amend its accounting guidance on the presentation of other comprehensive income (OCI) in an entity's financial statements. The amended guidance eliminates the option to present the components of OCI as part of the statement of changes in stockholders' equity and provides two options for presenting OCI: in a statement included in the statements of comprehensive income or in a separate statement immediately following the statements of comprehensive income. The amendments do not change the guidance for the items that have to be reported in OCI or when an item of OCI has to be moved into net income. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15,

Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

2011. The Company adopted ASU 2011-05 on January 1, 2012, and has included the required disclosures in its consolidated financial statements.

**Table of Contents**

**PORTFOLIO RECOVERY ASSOCIATES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

In September 2011, the FASB issued ASU 2011-08, Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment to amend the accounting guidance on goodwill impairment testing. The amended guidance reduces the complexity and costs of goodwill impairment testing by allowing an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it should calculate the fair value of a reporting unit. The amended guidance also improves previous guidance by expanding upon the examples of events and circumstances that an entity should consider between annual impairment tests in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The amendments are effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company adopted ASU 2011-08 on January 1, 2012 which had no material impact on its consolidated financial statements.



**Table of Contents**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations  
Cautionary Statements Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995:**

This report contains forward-looking statements within the meaning of the federal securities laws. These forward-looking statements involve risks, uncertainties and assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. All statements, other than statements of historical fact, are forward-looking statements, including statements regarding overall trends, gross margin trends, operating cost trends, liquidity and capital needs and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. The risks, uncertainties and assumptions referred to above may include the following:

a prolonged economic recovery or a deterioration in the economic or inflationary environment in the United States or the United Kingdom, including the interest rate environment, that may have an adverse effect on our collections, results of operations, revenue and stock price or on the stability of the financial system as a whole;

our ability to purchase defaulted consumer receivables at appropriate prices;

our ability to replace our defaulted consumer receivables with additional receivables portfolios;

our ability to obtain accurate and authentic account documents relating to accounts that we acquire and the possibility that documents that we provide could contain errors;

our ability to successfully acquire receivables of new asset types;

changes in the business practices of credit originators in terms of selling defaulted consumer receivables;

changes in government regulations that affect our ability to collect sufficient amounts on our defaulted consumer receivables;

changes in or interpretation of tax laws or adverse results of tax audits;

changes in bankruptcy or collection laws that could negatively affect our business, including by causing an increase in certain types of bankruptcy filings involving liquidations, which may cause our collections to decrease;

our ability to employ and retain qualified employees, especially collection personnel, and our senior management team;

our work force could become unionized in the future, which could adversely affect the stability of our production and increase our costs;

changes in the credit or capital markets, which affect our ability to borrow money or raise capital;

the degree and nature of our competition;

the possibility that we could incur goodwill impairment charges;

our ability to retain existing clients and obtain new clients for our fee-for-service businesses;

our ability to comply with regulations of the collection industry;

our ability to successfully operate and/or integrate new business acquisitions;

**Table of Contents**

our ability to maintain, renegotiate or replace our credit facility;

our ability to satisfy the restrictive covenants in our debt agreements;

our ability to manage risks associated with our international operations acquired on January 16, 2012;

the imposition of additional taxes on us;

changes in interest rates, which could reduce our net income, and the possibility that future hedging strategies may not be successful, which could adversely affect our results of operations and financial condition, as could our failure to comply with hedge accounting principles and interpretations;

the possibility that we could incur significant allowance charges on our finance receivables;

our ability to manage growth successfully;

the possibility that we could incur business or technology disruptions, or not adapt to technological advances;

the possibility that we or our industry could experience negative publicity or reputational attacks;

the sufficiency of our funds generated from operations, existing cash and available borrowings to finance our current operations; and

the risk factors listed from time to time in our filings with the SEC.

You should assume that the information appearing in this quarterly report is accurate only as of the date it was issued. Our business, financial condition, results of operations and prospects may have changed since that date.

For a discussion of the risks, uncertainties and assumptions that could affect our future events, developments or results, you should carefully review the following Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as the discussion of Business and Risk Factors described in our 2011 Annual Report on Form 10-K, filed on February 28, 2012.

Our forward-looking statements could be wrong in light of these and other risks, uncertainties and assumptions. The future events, developments or results described in this report could turn out to be materially different. We have no obligation to publicly update or revise our forward-looking statements after the date of this report and you should not expect us to do so.

Investors should also be aware that while we do, from time to time, communicate with securities analysts and others, we do not, by policy, selectively disclose to them any material nonpublic information or other confidential commercial information. Accordingly, stockholders should not assume that we agree with any statement or report issued by any analyst regardless of the content of the statement or report. We do not, by policy, confirm forecasts or projections issued by others. Thus, to the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not our responsibility.

**Overview**

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

The Company is a specialized financial and business services company. Our primary business is the purchase, collection and management of portfolios of defaulted consumer receivables. We also service receivables on behalf of clients on either a commission or transaction-fee basis as well as providing class action claims settlement recovery services and related payment processing to our corporate clients.

The Company is headquartered in Norfolk, Virginia, and employs approximately 3,000 team members. The Company's shares of common stock are traded on the NASDAQ Global Select Market under the symbol PRAA.

**Table of Contents**

On January 16, 2012, we acquired 100% of the equity interest in MHH. Based in Kilmarnock, Scotland, MHH employs approximately 170 people and offers outsourced and contingent consumer debt recovery on behalf of banks, credit providers and debt purchasers, as well as distressed and dormant niche portfolio purchasing.

*Earnings Summary*

During the first quarter of 2012, net income attributable to the Company was \$25.5 million, or \$1.47 per diluted share, compared with \$23.1 million, or \$1.34 per diluted share, in the first quarter of 2011. Total revenue was \$140.1 million in the first quarter of 2012, up 25.4% from the same quarter one year earlier. Revenues in the recently completed quarter consisted of \$124.2 million in income recognized on finance receivables, net of allowance charges, and \$15.9 million in fee income. Income recognized on finance receivables, net of allowance charges, increased \$28.2 million, or 29.4%, over the same period in 2011, primarily as a result of a significant increase in cash collections. Cash collections were \$218.0 million in the first quarter of 2012, up 30.8% or \$51.3 million as compared to the first quarter of 2011. During the quarter, we recorded \$0.5 million in net allowance charges, compared with \$4.0 million in the comparable quarter of 2011. Our performance has been positively impacted by operational efficiencies surrounding the cash collections process, including the continued refinement of dialer technology and account scoring analytics as it relates to both legal and non-legal collection channels. Additionally, we have continued to develop our internal legal collection staff resources, which enables us to place accounts into that channel that otherwise would have been prohibitively expensive for legal action and to collect these accounts more efficiently and profitably.

Fee income increased from \$15.8 million in the first quarter of 2011 to \$15.9 million in the first quarter of 2012 primarily due to the acquisition of MHH in the first quarter of 2012 as well as increased revenue generated by our PRA Government Services ( PRA GS ) business offset by declines in fee income generated by our PRA Location Services ( PLS ) business and our claims processing business. The decline from PLS is due primarily to the adverse impact of the economic slowdown on automobile financing and related collateral recovery activities.

A summary of how our income was generated during the three months ended March 31, 2012 and 2011 is as follows:

(\$ in thousands)	For the Three Months Ended	
	March 31,	
	2012	2011
Cash collections	\$ 217,996	\$ 166,717
Amortization of finance receivables	(93,276)	(66,703)
Allowance charges	(494)	(4,040)
Finance receivable income	124,226	95,974
Fee income	15,920	15,803
Total revenue	\$ 140,146	\$ 111,777

Operating expenses were \$95.7 million in the first quarter of 2012, up 38.6% over the first quarter of 2011, due primarily to increases in compensation expense, legal collection costs, legal collection fees, outside fees and services and communications expense. Compensation expense increased primarily as a result of larger staff sizes, including the acquisition of MHH on January 16, 2012. Compensation and employee services expenses increased as total employees grew 21.4% to 3,014 as of March 31, 2012, from 2,482 as of March 31, 2011. Legal collection costs were \$23.7 million for the three months ended March 31, 2012 compared to \$9.3 million for the three months ended March 31, 2011, an increase of \$14.4 million or 154.8%. This increase was the result of an increased portfolio size as well as a refinement of our internal scoring methodology that expanded our account selections for legal action. This strategy to expand the accounts brought into the legal collection process resulted in significant initial expenses, which is expected to help drive additional future cash collections and revenue. Legal collection fees increased from \$5.7 million in the first quarter of 2011 to \$7.6 million in the first quarter of 2012, an increase of \$1.9 million or 33.3%. This increase was the result of an increase in cash collections from outside attorneys from \$25.4 million in the three months ended March 31, 2011 to \$34.9 million for the three months ended March 31, 2012, an increase of \$9.5 million or 37.4%. Outside fees and services increased primarily as a result of legal related expenses as well as increases in costs related to software development. Communication expenses increased primarily due to a growth in mailings resulting from an increase in special letter campaigns and a greater number of finance receivables to work.

**Table of Contents****Results of Operations**

The results of operations include the financial results of Portfolio Recovery Associates, Inc. and all of our subsidiaries, all of which are in the receivables management business. Under the guidance of the FASB ASC Topic 280 Segment Reporting (ASC 280), we have determined that we have several operating segments that meet the aggregation criteria of ASC 280, and therefore, we have one reportable segment, accounts receivable management, based on similarities among the operating units including homogeneity of services, service delivery methods and use of technology.

The following table sets forth certain operating data as a percentage of total revenues for the periods indicated:

	<b>For the Three Months</b>	
	<b>Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>Revenues:</b>		
Income recognized on finance receivables, net	88.6%	85.9%
Fee income	11.4%	14.1%
<b>Total revenues</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Operating expenses:</b>		
Compensation and employee services	28.3%	30.6%
Legal collection fees	5.4%	5.1%
Legal collection costs	16.9%	8.4%
Agent fees	1.2%	2.4%
Outside fees and services	4.2%	3.1%
Communication expenses	5.9%	5.6%
Rent and occupancy	1.1%	1.3%
Depreciation and amortization	2.6%	2.9%
Other operating expenses	2.7%	2.6%
<b>Total operating expenses</b>	<b>68.3%</b>	<b>62.0%</b>
Income from operations	31.7%	38.0%
<b>Other income and (expense):</b>		
Interest income	0.0%	0.0%
Interest expense	(1.9%)	(2.6%)
Income before income taxes	29.8%	35.4%
Provision for income taxes	11.8%	14.4%
Net income	18.0%	21.0%
Less net loss/(income) attributable to redeemable noncontrolling interest	0.2%	(0.5%)
Net income attributable to Portfolio Recovery Associates, Inc.	18.2%	20.5%

We use the following terminology throughout our reports:

Allowance charges refers to a reduction in income recognized on finance receivables on pools of finance receivables whose cash collection estimates are not received or projected to not be received.

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

Amortization rate refers to cash collections applied to principal on finance receivables as a percentage of total cash collections.

Buybacks refers to purchase price refunded by the seller due to the return of non-compliant accounts.

Cash collections refers to collections from customers on our owned portfolios.

Cash receipts refers to collections on our owned portfolios plus fee income.

## **Table of Contents**

Core accounts or portfolios refer to accounts or portfolios that are defaulted consumer receivables and are not in a bankrupt status upon purchase. These accounts are aggregated separately from purchased bankruptcy accounts. Core accounts do not include the accounts we purchase in the United Kingdom.

EBITDA refers to earnings before interest, taxes, depreciation and amortization.

Estimated remaining collections refers to the sum of all future projected cash collections on our owned portfolios.

Fee income refers to revenues generated from our fee-for-service subsidiaries.

Income recognized on finance receivables refers to income derived from our owned debt portfolios.

Income recognized on finance receivables, net refers to income derived from our owned debt portfolios and is shown net of allowance charges.

Net finance receivable balance is recorded on our balance sheet and refers to the purchase price less principal amortization and net allowance charges.

Principal amortization refers to cash collections applied to principal on finance receivables.

Purchase price refers to the cash paid to a seller to acquire defaulted consumer receivables, plus certain capitalized costs, less buybacks.

Purchased bankruptcy accounts or portfolios refer to accounts or portfolios that are in bankruptcy when we purchase them and as such are purchased as a pool of bankrupt accounts.

Total estimated collections refers to the actual cash collections, including cash sales, plus estimated remaining collections.

Total estimated collections to purchase price refers to the total estimated collections divided by the purchase price.

### ***Three Months Ended March 31, 2012 Compared To Three Months Ended March 31, 2011***

#### **Revenues**

Total revenues were \$140.1 million for the three months ended March 31, 2012, an increase of \$28.3 million, or 25.3%, compared to total revenues of \$111.8 million for the three months ended March 31, 2011.

#### ***Income Recognized on Finance Receivables, net***

Income recognized on finance receivables, net was \$124.2 million for the three months ended March 31, 2012, an increase of \$28.2 million, or 29.4%, compared to income recognized on finance receivables, net of \$96.0 million for the three months ended March 31, 2011. The increase was primarily due to an increase in cash collections on our finance receivables to \$218.0 million for the three months ended March 31, 2012, from \$166.7 million for the three months ended March 31, 2011, an increase of \$51.3 million or 30.8%. During the three months ended March 31, 2012, excluding the initial investment in the MHH portfolio, we acquired defaulted consumer receivables portfolios with an aggregate



## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

face value amount of \$1.46 billion at a cost of \$111.4 million. During the three months ended March 31, 2011, we acquired defaulted consumer receivable portfolios with an aggregate face value of \$1.49 billion at a cost of \$107.9 million. In any period, we acquire defaulted consumer receivables that can vary dramatically in their age, type and ultimate collectability. We may pay significantly different purchase rates for purchased receivables within any period as a result of this quality fluctuation. In addition, market forces can drive pricing rates up or down in any period, irrespective of other quality fluctuations. As a result, the average purchase rate paid for any given period can fluctuate dramatically based on our particular buying activity in that period. However, regardless of the average purchase price and for similar time frames, we intend to target a similar internal rate of return, after direct expenses, in pricing our portfolio acquisitions; therefore, the absolute rate paid is not necessarily relevant to the estimated profitability of a period's buying.

---

**Table of Contents**

Income recognized on finance receivables, net is shown net of changes in valuation allowances recognized under FASB ASC Topic 310-30

Loans and Debt Securities Acquired with Deteriorated Credit Quality ( ASC 310-30 ), which requires that a valuation allowance be recorded for significant decreases in expected cash flows or a change in timing of cash flows which would otherwise require a reduction in the stated yield on a pool of accounts. For the three months ended March 31, 2012, we recorded net allowance charges of \$0.5 million, of which \$1.0 million related to purchased bankruptcy portfolios primarily purchased in 2008, offset by a net allowance reversal of \$0.5 million on Core portfolios. In any given period, we may be required to record valuation allowances due to pools of receivables underperforming our expectations. Factors that may contribute to the recording of valuation allowances may include both internal as well as external factors. External factors which may have an impact on the collectability, and subsequently to the overall profitability, of purchased pools of defaulted consumer receivables include: new laws or regulations relating to collections, new interpretations of existing laws or regulations, and the overall condition of the economy. Internal factors which may have an impact on the collectability, and subsequently the overall profitability, of purchased pools of defaulted consumer receivables would include: necessary revisions to initial and post-acquisition scoring and modeling estimates, non-optimal operational activities (which relates to the collection and movement of accounts on both our collection floor and external channels), as well as decreases in productivity related to turnover and tenure of our collection staff.

*Fee Income*

Fee income was \$15.9 million for the three months ended March 31, 2012, an increase of \$0.1 million, or 0.6%, compared to fee income of \$15.8 million for the three months ended March 31, 2011. Fee income increased due to the addition of MHH in the first quarter of 2012 as well as increased revenue generated by our PRA GS business offset by declines in fee income generated by our PLS business and our claims processing business. The decline associated with PLS is due primarily to the adverse impact of the economic slowdown on automobile financing and related collateral recovery activities, while the decline in our claims processing fee income relates to the variable nature in which claim filings are settled.

**Operating Expenses**

Total operating expenses were \$95.7 million for the three months ended March 31, 2012, an increase of \$26.6 million or 38.5% compared to total operating expenses of \$69.1 million for the three months ended March 31, 2011. Total operating expenses were 40.9% of cash receipts for the three months ended March 31, 2012 compared to 37.8% for the same period in 2011.

*Compensation and Employee Services*

Compensation and employee services expenses were \$39.7 million for the three months ended March 31, 2012, an increase of \$5.5 million, or 16.1%, compared to compensation and employee services expenses of \$34.2 million for the three months ended March 31, 2011. Compensation expense increased primarily as a result of larger staff sizes, including the addition of new employees as a result of the acquisition of MHH on January 16, 2012. Compensation and employee services expenses increased as total employees grew 21.4% to 3,014 as of March 31, 2012, from 2,482 as of March 31, 2011. Compensation and employee services expenses as a percentage of cash receipts decreased to 17.0% for the three months ended March 31, 2012, from 18.7% of cash receipts for the same period in 2011.

*Legal Collection Fees*

Legal collection fees represent the contingent fees for the cash collections generated by our independent third party attorney network. Legal collection fees were \$7.6 million for the three months ended March 31, 2012, an increase of \$1.9 million, or 33.3%, compared to legal collection fees of \$5.7 million for the three months ended March 31, 2011. This increase was the result of an increase in our external legal collections which increased \$9.5 million or 37.4%, from \$25.4 million for the three months ended March 31, 2011 to \$34.9 million for the three months ended March 31, 2012. Legal collection fees for the three months ended March 31, 2012 were 3.3% of cash receipts, compared to 3.1% for the three months ended March 31, 2011.

---

**Table of Contents***Legal Collection Costs*

Legal collection costs are costs paid to courts where a lawsuit is filed. It also includes the cost of documents received from sellers of defaulted consumer receivables. Legal collection costs were \$23.7 million for the three months ended March 31, 2012, an increase of \$14.4 million, or 154.8%, compared to legal collection costs of \$9.3 million for the three months ended March 31, 2011. This increase was the result of an increased portfolio size as well as a refinement of our internal scoring methodology that expanded our account selections for legal action. This strategy to expand the accounts brought into the legal collection process resulted in significant initial expenses, which is expected to help drive additional future cash collections and revenue. These legal collection costs represent 10.1% and 5.1% of cash receipts for the three month periods ended March 31, 2012 and 2011, respectively.

*Agent Fees*

Agent fees primarily represent costs paid to repossession agents to repossess vehicles. Agent fees were \$1.6 million for the three months ended March 31, 2012, a decrease of \$1.0 million, or 38.5%, compared to agent fees of \$2.6 million for the three months ended March 31, 2011. The decrease was primarily due to a decline in agent fees related to reduced business activity associated with PRA LS.

*Outside Fees and Services*

Outside fees and services expenses were \$5.9 million for the three months ended March 31, 2012, an increase of \$2.5 million or 73.5% compared to outside fees and services expenses of \$3.4 million for the three months ended March 31, 2011. Of the \$2.5 million increase, \$1.1 million increase was attributable to an increase in corporate legal expense and the remaining \$1.4 million increase was attributable to other outside fees and services including increases in non-capitalized software development costs.

*Communication Expenses*

Communication expenses were \$8.3 million for the three months ended March 31, 2012, an increase of \$2.0 million, or 31.7%, compared to communications expenses of \$6.3 million for the three months ended March 31, 2011. The increase was primarily due to additional postage expense resulting from an increase in special letter campaigns. The remaining increase was attributable to higher telephone expenses driven by a greater number of finance receivables to work, as well as a significant expansion of our dialer capacity and a resulting increase in the number of calls generated by the dialer. Mailings were responsible for 95.0% or \$1.9 million of this increase, while the remaining 5.0% or \$0.1 million was attributable to increased call volumes.

*Rent and Occupancy*

Rent and occupancy expenses were \$1.6 million for the three months ended March 31, 2012, an increase of \$0.2 million, or 14.3%, compared to rent and occupancy expenses of \$1.4 million for the three months ended March 31, 2011. The increase was primarily due to the additional space leased for our Birmingham call center operations, the addition of our MHH foreign operations as well as increased utility charges.

*Depreciation and Amortization*

Depreciation and amortization expenses were \$3.7 million for the three months ended March 31, 2012, an increase of \$0.5 million or 15.6% compared to depreciation and amortization expenses of \$3.2 million for the three months ended March 31, 2011. The increase was primarily due to the additional depreciation and amortization expense incurred as a result of the acquisition of the tangible and intangible assets of MHH.

*Other Operating Expenses*

Other operating expenses were \$3.7 million for the three months ended March 31, 2012, an increase of \$0.8 million or 27.6% compared to other operating expenses of \$2.9 million for the three months ended March 31, 2011. Of the \$0.8 million increase, \$0.5 increase was primarily attributable to additional taxes, fees and licenses and other operating expenses incurred by our MHH. The majority of the remaining \$0.3 million increase is attributable to increases in gross receipts taxes incurred as a result of a growth in our revenues.

## **Table of Contents**

### **Interest Income**

Interest income was \$1,000 and \$0 for the three months ended March 31, 2012 and 2011, respectively.

### **Interest Expense**

Interest expense was \$2.7 million for the three months ended March 31, 2012, a decrease of \$0.2 million compared to interest expense of \$2.9 million for the three months ended March 31, 2011. The decrease was primarily due to a decrease in our average borrowings under our revolving credit facility for the three months ended March 31, 2012 compared to the same period in 2011 partially offset by an increase in our weighted average interest rate, which increased to 3.8% for the three months ended March 31, 2012, compared to 3.6% for the three months ended March 31, 2011.

### **Provision for Income Taxes**

Income tax expense was \$16.6 million for the three months ended March 31, 2012, an increase of \$0.5 million, or 3.1%, compared to income tax expense of \$16.1 million for the three months ended March 31, 2011. The increase is primarily due to an increase of 4.8% in income before taxes for the three months ended March 31, 2012, compared to the same period in 2011, offset by a decrease in the effective tax rate to 39.7% for the three months ended March 31, 2012, compared to an effective tax rate of 40.5% for the same period in 2011. The decrease in the effective tax rate is primarily attributable to a decrease in the state effective tax rate due to a change in the mix of income apportionment between various states.

**Table of Contents**

Below are certain key financial data and ratios for the periods indicated:

**FINANCIAL HIGHLIGHTS**

	Three Months Ended March 31,		%
	2012	2011	
<b><u>EARNINGS (in thousands)</u></b>			
Income recognized on finance receivables, net	\$ 124,226	\$ 95,974	29%
Fee income	15,920	15,803	1%
Total revenues	140,146	111,777	25%
Operating expenses	95,725	69,072	39%
Income from operations	44,421	42,705	4%
Net interest expense	2,652	2,867	-7%
Net income	25,189	23,709	6%
Net income attributable to Portfolio Recovery Associates, Inc.	25,462	23,121	10%
<b><u>PERIOD-END BALANCES (in thousands)</u></b>			
Cash and cash equivalents	\$ 28,068	\$ 35,443	-21%
Finance receivables, net	945,242	866,992	9%
Goodwill and intangible assets, net	124,659	78,893	58%
Total assets	1,142,026	1,020,099	12%
Line of credit	265,000	290,000	-9%
Total liabilities	502,531	489,136	3%
Total equity	620,712	515,710	20%
<b><u>FINANCE RECEIVABLE COLLECTIONS (dollars in thousands)</u></b>			
Cash collections	\$ 217,996	\$ 166,717	31%
Principal amortization without allowance charges	93,276	66,703	40%
Principal amortization with allowance charges	93,770	70,743	33%
Principal amortization w/ allowance charges as % of cash collections:			
Including fully amortized pools	43.0%	42.4%	1%
Excluding fully amortized pools	44.8%	45.3%	-1%
<b><u>ALLOWANCE FOR FINANCE RECEIVABLES (dollars in thousands)</u></b>			
Balance at period-end	\$ 87,065	\$ 80,447	8%
Allowance charge	494	4,040	-88%
Allowance charge to period-end net finance receivables	0.05%	0.47%	-89%
Allowance charge to net finance receivable income	0.40%	4.21%	-91%
Allowance charge to cash collections	0.23%	2.42%	-91%
<b><u>PURCHASES OF FINANCE RECEIVABLES (1) (dollars in thousands)</u></b>			
Purchase price - core	\$ 52,104	\$ 61,294	-15%
Face value - core	972,268	1,008,758	-4%
Purchase price - bankruptcy	56,892	46,607	22%
Face value - bankruptcy	368,447	482,941	-24%
Purchase price - total	108,996	107,901	1%
Face value - total	1,340,715	1,491,699	-10%
Number of portfolios - total	82	79	4%
<b><u>ESTIMATED REMAINING COLLECTIONS (1) (in thousands)</u></b>			
Estimated remaining collections - core	\$ 1,226,292	\$ 1,040,140	18%
Estimated remaining collections - bankruptcy	796,161	753,130	6%

Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

Estimated remaining collections - total	2,022,453	1,793,270	13%
<b>SHARE DATA (share amounts in thousands)</b>			
Net income per common share - diluted	\$ 1.47	\$ 1.34	10%
Weighted average number of shares outstanding - diluted	17,267	17,199	0%
Shares repurchased	30,600		100%
Average price paid per share repurchased (including acquisitions costs)	\$ 68.02		100%
Closing market price	\$ 71.72	\$ 85.13	-16%
<b>RATIOS AND OTHER DATA (dollars in thousands)</b>			
Return on average equity (2)	16.70%	18.25%	-8%
Return on revenue (3)	17.97%	21.21%	-15%
Operating margin (4)	31.70%	38.21%	-17%
Operating expense to cash receipts (5)	40.92%	37.84%	8%
Debt to equity (6)	42.84%	56.64%	-24%
Number of collectors	1,934	1,486	30%
Number of employees	3,014	2,482	21%
Cash receipts (5)	\$ 233,916	\$ 182,520	28%
Line of credit - unused portion at period end	142,500	117,500	21%

- (1) Domestic portfolio only
- (2) Calculated as annualized net income divided by average equity for the period
- (3) Calculated as net income divided by total revenues
- (4) Calculated as income from operations divided by total revenues
- (5) Cash receipts is defined as cash collections plus fee income
- (6) For purposes of this ratio, debt equals the line of credit balance plus long-term debt

**Table of Contents****FINANCIAL HIGHLIGHTS**

	For the Quarter Ended				
	March 31 2012	December 31 2011	September 30 2011	June 30 2011	March 31 2011
<b><u>EARNINGS (in thousands)</u></b>					
Income recognized on finance receivables, net	\$ 124,226	\$ 102,743	\$ 102,875	\$ 100,303	\$ 95,974
Fee income	15,920	15,344	11,401	14,492	15,803
Total revenues	140,146	118,087	114,276	114,795	111,777
Operating expenses	95,725	72,134	70,447	70,415	69,072
Income from operations	44,421	45,953	43,830	45,536	42,705
Net interest expense	2,652	2,512	2,548	2,635	2,867
Net income	25,189	26,666	25,193	25,575	23,709
Net income attributable to Portfolio Recovery Associates, Inc.	25,462	26,590	25,506	25,574	23,121
<b><u>PERIOD-END BALANCES (in thousands)</u></b>					
Cash and cash equivalents	\$ 28,068	\$ 26,697	\$ 30,035	\$ 25,481	\$ 35,443
Finance receivables, net	945,242	926,734	919,478	879,515	866,992
Goodwill and intangible assets, net	124,659	76,274	76,426	77,643	78,893
Total assets	1,142,026	1,071,123	1,064,104	1,021,617	1,020,099
Line of credit	265,000	220,000	260,000	250,000	290,000
Total liabilities	502,531	457,804	478,915	463,153	489,136
Total equity	620,712	595,488	568,305	542,396	515,710
<b><u>FINANCE RECEIVABLE COLLECTIONS</u></b>					
<b><u>(dollars in thousands)</u></b>					
Cash collections	\$ 217,996	\$ 180,324	\$ 182,168	\$ 176,281	\$ 166,717
Principal amortization without allowance charges	93,276	74,481	78,552	73,695	66,703
Principal amortization with allowance charges	93,770	77,581	79,293	75,978	70,743
Principal amortization w/ allowance charges as % of cash collections:					
Including fully amortized pools	43.0%	43.0%	43.5%	43.1%	42.4%
Excluding fully amortized pools	44.8%	44.9%	45.7%	45.7%	45.3%
<b><u>ALLOWANCE FOR FINANCE RECEIVABLES</u></b>					
<b><u>(dollars in thousands)</u></b>					
Balance at period-end	\$ 87,065	\$ 86,571	\$ 83,471	\$ 82,730	\$ 80,447
Allowance charge	494	3,100	741	2,283	4,040
Allowance charge to period-end net finance receivables	0.05%	0.33%	0.08%	0.26%	0.47%
Allowance charge to net finance receivable income	0.40%	3.02%	0.72%	2.28%	4.21%
Allowance charge to cash collections	0.23%	1.72%	0.41%	1.30%	2.42%
<b><u>PURCHASES OF FINANCE RECEIVABLES</u></b>					
<b><u>(1) (dollars in thousands)</u></b>					
Purchase price - core	\$ 52,104	\$ 42,532	\$ 57,240	\$ 52,323	\$ 61,294
Face value - core	972,268	829,232	5,027,874	1,034,898	1,008,758
Purchase price - bankruptcy	56,892	46,360	64,848	37,204	46,607
Face value - bankruptcy	368,447	376,094	654,508	378,051	482,941
Purchase price - total	108,996	88,892	122,088	89,527	107,901
Face value - total	1,340,715	1,205,326	5,682,382	1,412,949	1,491,699
Number of portfolios - total	82	83	95	76	79
<b><u>ESTIMATED REMAINING COLLECTIONS</u></b>					
<b><u>(1) (in thousands)</u></b>					
Estimated remaining collections - core	\$ 1,226,292	\$ 1,159,086	\$ 1,154,406	\$ 1,072,777	\$ 1,040,140
Estimated remaining collections - bankruptcy	796,161	794,262	770,886	743,228	753,130

Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

Estimated remaining collections - total	2,022,453	1,953,348	1,925,292	1,816,005	1,793,270
---	-----------	-----------	-----------	-----------	-----------

**SHARE DATA (share amounts in thousands)**

Net income per common share - diluted	\$ 1.47	\$ 1.54	\$ 1.48	\$ 1.48	\$ 1.34
Weighted average number of shares outstanding - diluted	17,267	17,269	17,228	17,225	17,199
Shares repurchased	30,600				
Average price paid per share repurchased (including acquisitions costs)	\$ 68.02				
Closing market price	\$ 71.72	\$ 67.52	\$ 62.22	\$ 84.79	\$ 85.13

**RATIOS AND OTHER DATA (dollars in thousands)**

Return on average equity (2)	16.70%	18.18%	18.27%	19.20%	18.25%
Return on revenue (3)	17.97%	22.58%	22.05%	22.28%	21.21%
Operating margin (4)	31.70%	38.91%	38.35%	39.67%	38.21%
Operating expense to cash receipts (5)	40.92%	36.87%	36.39%	36.91%	37.84%
Debt to equity (6)	42.84%	37.15%	46.02%	46.43%	56.64%
Number of collectors	1,934	1,658	1,520	1,517	1,486
Number of employees	3,014	2,641	2,504	2,504	2,482
Cash receipts (5)	\$ 233,916	\$ 195,668	\$ 193,569	\$ 190,773	\$ 182,520
Line of credit - unused portion at period end	142,500	187,500	147,500	157,500	117,500

- (1) Domestic portfolio only
- (2) Calculated as annualized net income divided by average equity for the period
- (3) Calculated as net income divided by total revenues
- (4) Calculated as income from operations divided by total revenues
- (5) Cash receipts is defined as cash collections plus fee income
- (6) For purposes of this ratio, debt equals the line of credit balance plus long-term debt



## **Table of Contents**

### **Supplemental Performance Data**

#### *Domestic Owned Portfolio Performance:*

The following tables show certain data related to our domestic owned portfolio. These tables describe the purchase price, actual cash collections and future estimates of cash collections, income recognized on finance receivables (gross and net of allowance charges), principal amortization, allowance charges, net finance receivable balances and related multiples. Further, these tables disclose our entire domestic portfolio, as well as its subsets: the portfolio of purchased bankrupt accounts and our Core portfolio which are further broken down into year-to-date and life-to-date tables. The accounts represented in the purchased bankruptcy tables are those portfolios of accounts that were bankrupt at the time of purchase. This contrasts with accounts that file for bankruptcy after we purchase them, which continue to be tracked in their corresponding Core portfolio. Our United Kingdom portfolio is not significant and is therefore not included in these tables.

Core customers sometimes file for bankruptcy protection subsequent to our purchase of the related Core portfolio. When this occurs, we adjust our collection practices accordingly to comply with bankruptcy procedures; however, for accounting purposes, these accounts remain in the related Core portfolio. Conversely, bankrupt accounts may be dismissed voluntarily or involuntarily subsequent to our purchase of the related bankrupt portfolio. Dismissal occurs when the terms of the bankruptcy are not met by the petitioner. When this occurs, we are typically free to pursue collection outside of bankruptcy procedures; however, for accounting purposes, these accounts remain in the related bankruptcy pool.

The purchase price multiples (the ratio of total estimated collections to purchase price) from 2005 through the first quarter of 2012 described in the tables below are lower than multiples in previous years. This trend is primarily, but not entirely, related to pricing competition. When competition increases, and/or supply decreases so that pricing becomes negatively impacted on a relative basis (total lifetime collections in relation to purchase price), yields tend to trend lower. The opposite occurs when pricing trends are favorable.

To the extent that lower purchase price multiples are the ultimate result of more competitive pricing and lower yields, this will generally lead to higher amortization rates (payments applied to principal as a percentage of cash collections), lower operating margins and ultimately lower profitability. As portfolio pricing becomes more favorable on a relative basis, our profitability will tend to increase. It is important to consider, however, that to the extent we can improve our collection operations by collecting additional cash from a discreet quantity and quality of accounts, and/or by collecting cash at a lower cost structure, we can positively impact the collection to purchase price ratio and operating margins. We continue to make significant enhancements to our analytical abilities, management personnel and capabilities, all with the intent to collect more cash at lower cost.

Additionally, however, the processes we employ to initially book newly acquired pools of accounts and forecast future estimated collections for any given portfolio of accounts has evolved over the years due to a number of factors including economic conditions. Our revenue recognition under ASC 310-30 is driven by estimates of the ultimate magnitude of estimated lifetime collections as well as the timing of those collections. We have progressed towards booking new portfolio purchases using a higher confidence level for both estimated collection amounts and timing. Subsequent to the initial booking, as we gain collection experience and comfort with a pool of accounts, we continuously update ERC. These processes, along with the aforementioned operational enhancements, have tended to cause the ratio of collections, including ERC, to purchase price for any given year of buying to gradually increase over time. As a result, our estimate of lifetime collections to purchase price has generally, but not always, shown relatively steady increases as pools have aged. Thus, all factors being equal in terms of pricing, one would typically tend to see a higher collection to purchase price ratio from a pool of accounts that was six years from purchase than say a pool that was just two years from purchase.

**Table of Contents****Domestic Portfolio Data - Life-to-Date****Entire Portfolio**

Purchase Period	Actual Cash		Inception through March 31, 2012				Income			As of March 31, 2012		Total Estimated Collections to Purchase Price
	Purchase Price	Collections Including Cash Sales	Recognized on Finance Receivables	Principal Amortization	Allowance Charges	Recognized on Finance Receivables, Net	Net Finance Receivables Balance	Estimated Remaining Collections	Total Estimated Collections			
										Income	Income	
1996	\$ 3,080	\$ 10,152	\$ 7,029	\$ 3,123	\$ 0	\$ 7,029	\$ 0	\$ 82	\$ 10,234	332%		
1997	7,685	25,340	17,236	8,104	0	17,236	0	202	25,542	332%		
1998	11,089	36,990	26,003	10,987	0	26,003	0	424	37,414	337%		
1999	18,898	68,379	49,205	19,174	0	49,205	0	1,317	69,696	369%		
2000	25,020	113,991	88,795	25,196	0	88,795	0	3,520	117,511	470%		
2001	33,481	171,380	137,027	34,353	0	137,027	0	4,958	176,338	527%		
2002	42,325	191,646	149,321	42,325	0	149,321	0	8,168	199,814	472%		
2003	61,448	254,623	193,175	61,448	0	193,175	0	13,781	268,404	437%		
2004	59,176	189,039	131,061	57,978	1,200	129,861	0	12,982	202,021	341%		
2005	143,169	291,628	175,602	116,026	16,590	159,012	10,553	19,619	311,247	217%		
2006	107,693	190,961	119,449	71,512	20,315	99,134	15,865	27,090	218,051	202%		
2007	258,392	416,948	231,857	185,091	19,565	212,292	53,731	95,339	512,287	198%		
2008	275,160	379,407	223,469	155,938	29,395	194,074	89,792	145,637	525,044	191%		
2009	281,446	468,207	302,090	166,117	0	302,090	115,329	323,285	791,492	281%		
2010	358,166	364,189	208,658	155,531	0	208,658	202,659	471,352	835,541	233%		
2011	399,462	133,533	77,750	55,783	0	77,750	343,679	701,469	835,002	209%		
2012	109,104	3,543	2,690	853	0	2,690	108,238	193,228	196,771	180%		
<b>Total</b>	<b>\$ 2,194,794</b>	<b>\$ 3,309,956</b>	<b>\$ 2,140,417</b>	<b>\$ 1,169,539</b>	<b>\$ 87,065</b>	<b>\$ 2,053,352</b>	<b>\$ 939,846</b>	<b>\$ 2,022,453</b>	<b>\$ 5,332,409</b>	<b>243%</b>		

**Purchased Bankruptcy Portfolio**

Purchase Period	Actual Cash		Inception through March 31, 2012				Income			As of March 31, 2012		Total Estimated Collections to Purchase Price
	Purchase Price	Collections Including Cash Sales	Recognized on Finance Receivables	Principal Amortization	Allowance Charges	Recognized on Finance Receivables, Net	Net Finance Receivables Balance	Estimated Remaining Collections	Total Estimated Collections			
										Income	Income	
1996-2003	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	0%	
2004	7,468	14,325	8,056	6,269	1,200	6,856	0	154	14,479	194%		
2005	29,301	43,289	14,682	28,607	645	14,037	50	123	43,412	148%		
2006	17,645	30,700	14,266	16,434	1,100	13,166	111	614	31,314	177%		
2007	78,547	98,127	34,576	63,551	5,710	28,866	9,286	11,104	109,231	139%		
2008	108,609	131,477	63,582	67,895	2,300	61,282	38,414	50,637	182,114	168%		
2009	156,057	227,414	146,024	81,390	0	146,024	74,667	166,390	393,804	252%		
2010	209,231	173,170	95,051	78,119	0	95,051	131,112	224,544	397,714	190%		
2011	186,184	27,767	17,634	10,133	0	17,634	176,051	263,966	291,733	157%		
2012	56,889	1,075	633	442	0	633	56,446	78,629	79,704	140%		
<b>Total</b>	<b>\$ 849,931</b>	<b>\$ 747,344</b>	<b>\$ 394,504</b>	<b>\$ 352,840</b>	<b>\$ 10,955</b>	<b>\$ 383,549</b>	<b>\$ 486,137</b>	<b>\$ 796,161</b>	<b>\$ 1,543,505</b>	<b>182%</b>		

Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

Core Portfolio

Purchase Period	Actual Cash		Inception through March 31, 2012			Income			As of March 31, 2012	
	Purchase Price	Collections Including Cash Sales	Recognized on Finance Receivables	Principal Amortization	Allowance Charges	Recognized on Finance Receivables, Net	Net Finance Receivables Balance	Estimated Remaining Collections	Total Estimated Collections	Total Estimated Collections to Purchase Price
1996	\$ 3,080	\$ 10,152	\$ 7,029	\$ 3,123	\$ 0	\$ 7,029	\$ 0	\$ 82	\$ 10,234	332%
1997	7,685	25,340	17,236	8,104	0	17,236	0	202	25,542	332%
1998	11,089	36,990	26,003	10,987	0	26,003	0	424	37,414	337%
1999	18,898	68,379	49,205	19,174	0	49,205	0	1,317	69,696	369%
2000	25,020	113,991	88,795	25,196	0	88,795	0	3,520	117,511	470%
2001	33,481	171,380	137,027	34,353	0	137,027	0	4,958	176,338	527%
2002	42,325	191,646	149,321	42,325	0	149,321	0	8,168	199,814	472%
2003	61,448	254,623	193,175	61,448	0	193,175	0	13,781	268,404	437%
2004	51,708	174,714	123,005	51,709	0	123,005	0	12,828	187,542	363%
2005	113,868	248,339	160,920	87,419	15,945	144,975	10,503	19,496	267,835	235%
2006	90,048	160,261	105,183	55,078	19,215	85,968	15,754	26,476	186,737	207%
2007	179,845	318,821	197,281	121,540	13,855	183,426	44,445	84,235	403,056	224%
2008	166,551	247,930	159,887	88,043	27,095	132,792	51,378	95,000	342,930	206%
2009	125,389	240,793	156,066	84,727	0	156,066	40,662	156,895	397,688	317%
2010	148,935	191,019	113,607	77,412	0	113,607	71,547	246,808	437,827	294%
2011	213,278	105,766	60,116	45,650	0	60,116	167,628	437,503	543,269	255%
2012	52,215	2,468	2,057	411	0	2,057	51,792	114,599	117,067	224%
Total	\$ 1,344,863	\$ 2,562,612	\$ 1,745,913	\$ 816,699	\$ 76,110	\$ 1,669,803	\$ 453,709	\$ 1,226,292	\$ 3,788,904	282%

**Table of Contents****Domestic Portfolio Data - Quarter-to-Date****Entire Portfolio**

Purchase Period	Quarter to Date March 31, 2012						As of March 31, 2012				
	Actual	Income			Income		Net Finance Receivables Balance	Estimated Remaining Collections	Total Estimated Collections	Total Estimated Collections to Purchase Price	
	Cash	Recognized on Finance Receivables	Principal Amortization	Allowance Charges	Recognized on Finance Receivables, Net	Cash					
	Purchase Price	Including Cash Sales	Recognized on Finance Receivables	Principal Amortization	Allowance Charges	Recognized on Finance Receivables, Net	Net Finance Receivables Balance	Estimated Remaining Collections	Total Estimated Collections	Total Estimated Collections to Purchase Price	
1996	\$ 3,080	\$ 8	\$ 8	\$ 0	\$ 0	\$ 8	\$ 0	\$ 82	\$ 10,234	332%	
1997	7,685	30	30	0	0	30	0	202	25,542	332%	
1998	11,089	52	52	0	0	52	0	424	37,414	337%	
1999	18,898	217	217	0	0	217	0	1,317	69,696	369%	
2000	25,020	603	603	0	0	603	0	3,520	117,511	470%	
2001	33,481	916	916	0	0	916	0	4,958	176,338	527%	
2002	42,325	1,369	1,369	0	0	1,369	0	8,168	199,814	472%	
2003	61,448	2,226	2,226	0	0	2,226	0	13,781	268,404	437%	
2004	59,176	1,889	1,889	0	0	1,889	0	12,982	202,021	341%	
2005	143,169	3,744	1,676	2,068	(1,356)	3,032	10,553	19,619	311,247	217%	
2006	107,693	3,805	2,070	1,735	(100)	2,170	15,865	27,090	218,051	202%	
2007	258,392	14,721	6,347	8,374	100	6,247	53,731	95,339	512,287	198%	
2008	275,160	20,475	8,603	11,872	1,850	6,753	89,792	145,637	525,044	191%	
2009	281,446	46,343	29,962	16,381	0	29,962	115,329	323,285	791,492	281%	
2010	358,166	59,575	33,242	26,333	0	33,242	202,659	471,352	835,541	233%	
2011	399,462	56,344	31,805	24,539	0	31,805	343,679	701,469	835,002	209%	
2012	109,104	3,543	2,690	853	0	2,690	108,238	193,228	196,771	180%	
Total	\$ 2,194,794	\$ 215,860	\$ 123,705	\$ 92,155	\$ 494	\$ 123,211	\$ 939,846	\$ 2,022,453	\$ 5,332,409	243%	

**Purchased Bankruptcy Portfolio**

Purchase Period	Quarter to Date March 31, 2012						As of March 31, 2012				
	Actual	Income			Income		Net Finance Receivables Balance	Estimated Remaining Collections	Total Estimated Collections	Total Estimated Collections to Purchase Price	
	Cash	Recognized on Finance Receivables	Principal Amortization	Allowance Charges	Recognized on Finance Receivables, Net	Cash					
	Purchase Price	Including Cash Sales	Recognized on Finance Receivables	Principal Amortization	Allowance Charges	Recognized on Finance Receivables, Net	Net Finance Receivables Balance	Estimated Remaining Collections	Total Estimated Collections	Total Estimated Collections to Purchase Price	
1996-2003	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	0%	
2004	7,468	31	31	0	0	31	0	154	14,479	194%	
2005	29,301	67	13	54	(36)	49	50	123	43,412	148%	
2006	17,645	219	147	72	(100)	247	111	614	31,314	177%	
2007	78,547	2,753	529	2,224	600	(71)	9,286	11,104	109,231	139%	
2008	108,609	7,895	2,637	5,258	500	2,137	38,414	50,637	182,114	168%	
2009	156,057	26,219	15,660	10,559	0	15,660	74,667	166,390	393,804	252%	
2010	209,231	29,186	13,717	15,469	0	13,717	131,112	224,544	397,714	190%	
2011	186,184	12,549	7,128	5,421	0	7,128	176,051	263,966	291,733	157%	
2012	56,889	1,075	633	442	0	633	56,446	78,629	79,704	140%	
Total	\$ 849,931	\$ 79,994	\$ 40,495	\$ 39,499	\$ 964	\$ 39,531	\$ 486,137	\$ 796,161	\$ 1,543,505	182%	



Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

Core Portfolio

Purchase Period	Quarter to Date March 31, 2012						As of March 31, 2012				
	Actual Cash		Income			Income					Total Estimated
	Purchase Price	Collections Including Cash Sales	Recognized on Finance Receivables	Principal Amortization	Allowance Charges	Recognized on Finance Receivables, Net	Net Finance Receivables Balance	Estimated Remaining Collections	Total Estimated Collections	to Purchase Price	
1996	\$ 3,080	\$ 8	\$ 8	\$ 0	\$ 0	\$ 8	\$ 0	\$ 82	\$ 10,234	332%	
1997	7,685	30	30	0	0	30	0	202	25,542	332%	
1998	11,089	52	52	0	0	52	0	424	37,414	337%	
1999	18,898	217	217	0	0	217	0	1,317	69,696	369%	
2000	25,020	603	603	0	0	603	0	3,520	117,511	470%	
2001	33,481	916	916	0	0	916	0	4,958	176,338	527%	
2002	42,325	1,369	1,369	0	0	1,369	0	8,168	199,814	472%	
2003	61,448	2,226	2,226	0	0	2,226	0	13,781	268,404	437%	
2004	51,708	1,858	1,858	0	0	1,858	0	12,828	187,542	363%	
2005	113,868	3,677	1,663	2,014	(1,320)	2,983	10,503	19,496	267,835	235%	
2006	90,048	3,586	1,923	1,663	0	1,923	15,754	26,476	186,737	207%	
2007	179,845	11,968	5,818	6,150	(500)	6,318	44,445	84,235	403,056	224%	
2008	166,551	12,580	5,966	6,614	1,350	4,616	51,378	95,000	342,930	206%	
2009	125,389	20,124	14,302	5,822	0	14,302	40,662	156,895	397,688	317%	
2010	148,935	30,389	19,525	10,864	0	19,525	71,547	246,808	437,827	294%	
2011	213,278	43,795	24,677	19,118	0	24,677	167,628	437,503	543,269	255%	
2012	52,215	2,468	2,057	411	0	2,057	51,792	114,599	117,067	224%	
Total	\$ 1,344,863	\$ 135,866	\$ 83,210	\$ 52,656	(\$ 470)	\$ 83,680	\$ 453,709	\$ 1,226,292	\$ 3,788,904	282%	

## **Table of Contents**

The following graph shows the purchase price of our owned domestic portfolios by year and includes the year to date acquisition amount for the three months ended March 31, 2012. The purchase price number represents the cash paid to the seller, plus certain capitalized costs, less buybacks.

As shown in the above chart, the composition of our domestic purchased portfolios has shifted in favor of bankrupt accounts in recent years. We began buying bankrupt accounts during 2004 and slowly increased the volume of accounts we acquired through 2006 as we tested our models, refined our processes and validated our operating assumptions. After observing a high level of modeling confidence in our early purchases, we began increasing our level of purchases more dramatically commencing in 2007.

Our ability to profitably purchase and liquidate pools of bankrupt accounts provides diversity to our distressed asset acquisition business. Although we generally buy bankrupt portfolios from many of the same consumer lenders from whom we acquire Core customer portfolios, the volumes and pricing characteristics as well as the competitors are different. Based upon market dynamics, the profitability of portfolios purchased in the bankrupt and Core markets may differ over time. We have found periods when bankrupt accounts were more profitable and other times when Core accounts were more profitable. From 2004 through 2008, our bankruptcy buying fluctuated between 13% and 39% of our total portfolio purchasing in those years. In 2009, for the first time in our history, bankruptcy purchasing exceeded that of our Core buying, finishing at 55% of total portfolio purchasing for the year and during 2010 this percentage increased to 59%. This occurred as severe dislocations in the financial markets, coupled with legislative uncertainty, caused pricing in the bankruptcy market to decline substantially, thereby driving our strategy to make advantageous bankruptcy portfolio acquisitions during this period. For 2011 and the first three months of 2012, bankruptcy buying represented 48% and 52%, respectively, of our total portfolio purchasing.

In order to collect our Core portfolios, we generally need to employ relatively higher amounts of labor and incur additional collection costs to generate each dollar of cash collections as compared with bankruptcy portfolios. In order to achieve acceptable levels of net return on investment (after direct expenses), we are generally targeting a total cash collections to purchase price multiple in the 2.25-3.0x range. On the other hand, bankrupt accounts generate the majority of cash collections through the efforts of the U.S. bankruptcy courts. In this process, cash is remitted to our Company with no corresponding cost other than the cost of filing claims at the time of purchase and general administrative costs for monitoring the progress of each account through the bankruptcy process. As a result, overall collection costs are much lower for us when liquidating a pool of bankrupt accounts as compared to a pool of Core accounts, but conversely the price we pay for bankrupt accounts is generally higher than Core accounts. We generally target similar returns on investment (measured after direct expenses) for bankrupt and Core portfolios at any given point in the market cycles. However, because of the lower related collection costs, we can pay more for bankrupt portfolios, which causes the estimated total cash collections to purchase price multiples of bankrupt pools to be in the 1.4-2.0x range generally. In summary, compared to a pool of Core accounts, to the extent both pools had identical targeted returns on investment (measured after direct expenses), the bankrupt pool would be expected to generate less revenue, a lower yield, less direct expenses, similar operating income, and a higher operating margin.

**Table of Contents**

In addition, collections on younger, newly filed bankrupt accounts tend to be of a lower magnitude in the earlier months when compared to Core charge-off accounts. This lower level of early period collections is due to the fact that we primarily purchase portfolios of accounts that represent unsecured claims in bankruptcy, and these unsecured claims are scheduled to begin paying out after payment of the secured and priority claims. As a result of the administrative processes regarding payout priorities within the court-administered bankruptcy plans, unsecured creditors do not generally begin receiving meaningful collections on unsecured claims until 12 to 18 months after the bankruptcy filing date. Therefore, to the extent that we purchase portfolios with more recent bankruptcy filing dates, as we did to a significant extent commencing in 2009, we would expect to experience a delay in cash collections compared with Core charged-off portfolios.

We utilize a long-term approach to collecting our owned portfolios of receivables. This approach has historically caused us to realize significant cash collections and revenues from purchased portfolios of finance receivables years after they are originally acquired. As a result, we have in the past been able to temporarily reduce our level of current period acquisitions without a corresponding negative current period impact on cash collections and revenue.

The following tables, which exclude any proceeds from cash sales of finance receivables, demonstrate our ability to realize significant multi-year cash collection streams on our domestic owned portfolios.

**Cash Collections By Year, By Year of Purchase - Entire Domestic Portfolio**

Purchase Price	Cash Collection Period											
	1996-2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD 2012	Total
\$ 3,080	\$ 8,521	\$ 398	\$ 285	\$ 210	\$ 237	\$ 102	\$ 83	\$ 78	\$ 68	\$ 100	\$ 8	\$ 1,000
7,685	19,597	1,324	1,022	860	597	437	346	215	216	187	30	2,000
11,089	26,081	2,797	2,200	1,811	1,415	882	616	397	382	332	52	3,000
18,898	39,895	7,336	5,615	4,352	3,032	2,243	1,533	1,328	1,139	997	217	6,000
25,020	45,870	16,628	14,098	10,924	8,067	5,202	3,604	3,198	2,782	2,554	603	11,000
33,481	41,879	28,003	26,717	22,639	16,048	10,011	6,164	5,299	4,422	3,791	916	16,000
42,325	15,073	36,258	35,742	32,497	24,729	16,527	9,772	7,444	6,375	5,844	1,369	19,000
61,448		24,308	49,706	52,640	43,728	30,695	18,818	13,135	10,422	8,945	2,226	25,000
59,176			18,019	46,475	40,424	30,750	19,339	13,677	9,944	8,522	1,889	18,000
143,169				18,968	75,145	69,862	49,576	33,366	23,733	17,234	3,744	29,000
107,693					22,971	53,192	40,560	29,749	22,494	18,190	3,805	19,000
258,392						42,263	115,011	94,805	83,059	67,088	14,721	41,000
275,160							61,277	107,974	100,337	89,344	20,475	37,000
281,446								57,338	177,407	187,119	46,343	46,000
358,166									86,562	218,053	59,575	36,000
399,462										77,190	56,344	13,000
109,104											3,543	0
\$ 2,194,794	\$ 196,916	\$ 117,052	\$ 153,404	\$ 191,376	\$ 236,393	\$ 262,166	\$ 326,699	\$ 368,003	\$ 529,342	\$ 705,490	\$ 215,860	\$ 3,300,000

**Cash Collections By Year, By Year of Purchase - Purchased Bankruptcy Portfolio**

Purchase Price	Cash Collection Period											
	1996-2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD 2012	Total
\$ 7,468	\$	\$	\$ 743	\$ 4,554	\$ 3,956	\$ 2,777	\$ 1,455	\$ 496	\$ 164	\$ 149	\$ 31	\$ 1,000
29,301				3,777	15,500	11,934	6,845	3,318	1,382	466	67	4,000
17,645					5,608	9,455	6,522	4,398	2,972	1,526	219	3,000
78,547						2,850	27,972	25,630	22,829	16,093	2,753	9,000
108,609							14,024	35,894	37,974	35,690	7,895	13,000
156,057								16,635	81,780	102,780	26,219	22,000



Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

	209,231								39,486	104,499	29,186	17,012	
	186,184									15,218	12,549	2,012	
	56,889										1,075		
	\$ 849,931	\$	\$	\$ 743	\$ 8,331	\$ 25,064	\$ 27,016	\$ 56,818	\$ 86,371	\$ 186,587	\$ 276,421	\$ 79,994	\$ 74,012

Cash Collections By Year, By Year of Purchase - Core Portfolio

Purchase Price	Cash Collection Period												
	1996-2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD 2012	Total	
\$ 3,080	\$ 8,521	\$ 398	\$ 285	\$ 210	\$ 237	\$ 102	\$ 83	\$ 78	\$ 68	\$ 100	\$ 8	\$ 10,000	
7,685	19,597	1,324	1,022	860	597	437	346	215	216	187	30	2,012	
11,089	26,081	2,797	2,200	1,811	1,415	882	616	397	382	332	52	3,012	
18,898	39,895	7,336	5,615	4,352	3,032	2,243	1,533	1,328	1,139	997	217	6,012	
25,020	45,870	16,628	14,098	10,924	8,067	5,202	3,604	3,198	2,782	2,554	603	11,012	
33,481	41,879	28,003	26,717	22,639	16,048	10,011	6,164	5,299	4,422	3,791	916	16,012	
42,325	15,073	36,258	35,742	32,497	24,729	16,527	9,772	7,444	6,375	5,844	1,369	19,012	
61,448		24,308	49,706	52,640	43,728	30,695	18,818	13,135	10,422	8,945	2,226	25,012	
51,708			17,276	41,921	36,468	27,973	17,884	13,181	9,780	8,373	1,858	17,012	
113,868				15,191	59,645	57,928	42,731	30,048	22,351	16,768	3,677	24,012	
90,048					17,363	43,737	34,038	25,351	19,522	16,664	3,586	16,012	
179,845						39,413	87,039	69,175	60,230	50,995	11,968	31,012	
166,551							47,253	72,080	62,363	53,654	12,580	24,012	
125,389								40,703	95,627	84,339	20,124	24,012	
148,935									47,076	113,554	30,389	19,012	
213,278										61,972	43,795	10,012	
012	52,215										2,468		
	\$ 1,344,863	\$ 196,916	\$ 117,052	\$ 152,661	\$ 183,045	\$ 211,329	\$ 235,150	\$ 269,881	\$ 281,632	\$ 342,755	\$ 429,069	\$ 135,866	\$ 2,550,012

**Table of Contents**

When we acquire a new pool of finance receivables, our estimates typically result in a 60 - 96 month projection of cash collections, depending on the type of finance receivables acquired. The following chart shows our historical cash collections (including cash sales of finance receivables) in relation to the aggregate of the total estimated collection projections made at the time of each respective pool purchase, adjusted for buybacks, for the last ten years.

Primarily as a result of the downturn in the economy, the decline in the availability of consumer credit, our efforts to help customers establish reasonable payment plans, and improvements in our collections capabilities which have allowed us to profitably collect on accounts with lower balances or lower quality, the average payment size has decreased over the past several years. However, due to improved scoring and segmentation, together with enhanced productivity, we have been able to generate increased amounts of cash collections by generating enough incremental payments to overcome the decrease in payment size.

*Owned Portfolio Personnel Performance*

We measure the productivity of each collector each month. The following tables display various productivity measures that we track. The tables below contain our collector productivity metrics as defined by calendar quarter.

**QTD Cash Collections per Collector Hour Paid (Domestic Portfolio Only)**

	Core cash collections <sup>(1)</sup>					
	2007	2008	2009	2010	2011	2012
Q1	\$ 141	\$ 116	\$ 120	\$ 135	\$ 162	\$ 166
Q2	\$ 129	\$ 115	\$ 114	\$ 127	\$ 154	
Q3	\$ 120	\$ 110	\$ 111	\$ 127	\$ 152	
Q4	\$ 107	\$ 98	\$ 109	\$ 129	\$ 137	

	Total cash collections <sup>(2)</sup>					
	2007	2008	2009	2010	2011	2012
Q1	\$ 156	\$ 133	\$ 147	\$ 182	\$ 241	\$ 258
Q2	\$ 142	\$ 136	\$ 143	\$ 188	\$ 243	
Q3	\$ 131	\$ 134	\$ 144	\$ 200	\$ 249	
Q4	\$ 119	\$ 123	\$ 148	\$ 204	\$ 228	

**Table of Contents**

	Non-legal cash collections <sup>(3)</sup>					
	2007	2008	2009	2010	2011	2012
Q1	\$ 108	\$ 96	\$ 118	\$ 154	\$ 204	\$ 216
Q2	\$ 96	\$ 99	\$ 116	\$ 160	\$ 205	
Q3	\$ 88	\$ 99	\$ 119	\$ 170	\$ 212	
Q4	\$ 80	\$ 94	\$ 123	\$ 174	\$ 194	

  

	Non-legal/non-bankruptcy cash collections <sup>(4)</sup>					
	2007	2008	2009	2010	2011	2012
Q1	\$ 92	\$ 79	\$ 90	\$ 106	\$ 125	\$ 125
Q2	\$ 83	\$ 78	\$ 87	\$ 100	\$ 116	
Q3	\$ 76	\$ 76	\$ 87	\$ 97	\$ 115	
Q4	\$ 68	\$ 69	\$ 84	\$ 98	\$ 103	

- (1) Represents total cash collections less purchased bankruptcy cash collections from trustee-administered accounts. This metric includes cash collections from purchased bankruptcy accounts administered by the Core call center collection floor as well as cash collections generated by our internal staff of legal collectors. This calculation does not include hours paid to our internal staff of legal collectors or to employees processing the bankruptcy-required notifications to trustees.
- (2) Represents total cash collections (assigned and unassigned) divided by total hours paid (including holiday, vacation and sick time) to collectors (including those in training).
- (3) Represents total cash collections less external legal cash collections. This does includes internal legal collections and all bankruptcy collections and excludes any hours associated with either of those functions.
- (4) Represents total cash collections less external legal cash collections and less purchased bankruptcy cash collections from trustee-administered accounts. This metric also does not include any labor hours associated with the bankruptcy or legal (internal or external) functions but does include internally-driven cash collections from the internal legal channel.

The following chart illustrates the excess of our cash collections on our owned portfolios over income recognized on finance receivables on a quarterly basis. The difference between cash collections and income recognized on finance receivables is referred to as payments applied to principal. It is also referred to as amortization of purchase price. This amortization is the portion of cash collections that is used to recover the cost of the portfolio investment represented on the balance sheet.

- (1) Includes cash collections on finance receivables only and excludes cash proceeds from sales of defaulted consumer receivables.

**Table of Contents***Seasonality*

Collections tend to be higher in the first and second quarters of the year and lower in the third and fourth quarters of the year, due to customer payment patterns in connection with seasonal employment trends, income tax refunds and holiday spending habits. Historically, our growth has partially offset the impact of this seasonality.

The following table displays our quarterly cash collections by source, for the periods indicated.

Cash Collection Source (\$ in thousands)	Q12012	Q42011	Q32011	Q22011	Q12011	Q42010	Q32010	Q22010
Call Center & Other Collections	\$ 79,805	\$ 61,227	\$ 63,967	\$ 64,566	\$ 67,377	\$ 53,775	\$ 51,711	\$ 54,477
External Legal Collections	34,852	26,316	27,245	27,329	25,378	21,446	20,217	18,819
Internal Legal Collections	23,345	17,615	16,444	16,007	15,598	12,841	12,130	11,362
Purchased Bankruptcy Collections	79,994	75,166	74,512	68,379	58,364	56,301	53,319	43,748
<b>Total Cash Collections</b>	<b>\$ 217,996</b>	<b>\$ 180,324</b>	<b>\$ 182,168</b>	<b>\$ 176,281</b>	<b>\$ 166,717</b>	<b>\$ 144,363</b>	<b>\$ 137,377</b>	<b>\$ 128,406</b>

*Rollforward of Net Finance Receivables*

The following table shows the changes in finance receivables, net, including the amounts paid to acquire new portfolios (amounts in thousands).

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Balance at beginning of year	\$ 926,734	\$ 831,330
Acquisitions of finance receivables <sup>(1)</sup>	112,093	106,405
Foreign currency translation adjustment	185	
Cash collections applied to principal on finance receivables <sup>(2)</sup>	(93,770)	(70,743)
<b>Balance at end of year</b>	<b>\$ 945,242</b>	<b>\$ 866,992</b>
Estimated Remaining Collections	\$ 2,032,873	\$ 1,793,270

(1) Acquisitions of finance receivables is net of buybacks and includes certain capitalized acquisition related costs.

(2) Cash collections applied to principal (also referred to as amortization) on finance receivables consists of cash collections less income recognized on finance receivables, net of allowance charges.

*Portfolios by Type and Geography (Domestic Portfolio Only)*

The following table categorizes our life to date portfolio purchases as of March 31, 2012, into the major asset types represented (amounts in thousands):

Asset Type	No. of Accounts	%	Life to Date Purchased		Original Purchase	
			Face Value <sup>(1)</sup>	%	Price <sup>(2)</sup>	%
Major Credit Cards	16,776	59%	\$ 46,935,879	71%	\$ 1,677,196	75%
Consumer Finance	5,710	20	6,900,210	10	129,925	6

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

Private Label Credit Cards	5,471	19	7,696,958	12	392,958	17
Auto Deficiency	636	2	4,435,749	7	45,619	2
<b>Total:</b>	<b>28,593</b>	<b>100%</b>	<b>65,968,796</b>	<b>100%</b>	<b>2,245,698</b>	<b>100%</b>

- (1) Life to Date Purchased Face Value represents the original face amount purchased from sellers and has not been reduced by any adjustments including payments and buybacks.
- (2) Original Purchase Price represents the cash paid to sellers to acquire portfolios of defaulted consumer receivables.

**Table of Contents**

The following table summarizes our life to date portfolio purchases as of March 31, 2012, into the delinquency categories represented (amounts in thousands).

Account Type	No. of Accounts	%	Life to Date Purchased		Original Purchase	
			Face Value <sup>(1)</sup>	%	Price <sup>(2)</sup>	%
Fresh	1,881	7%	\$ 5,225,118	8%	\$ 478,108	21%
Primary	4,326	15	7,839,240	12	386,816	17
Secondary	4,921	17	7,814,107	12	290,718	13
Tertiary	4,002	14	5,404,334	8	75,298	3
BK Trustees	3,991	14	17,946,342	27	889,748	40
Other	9,472	33	21,739,655	33	125,010	6
<b>Total:</b>	<b>28,593</b>	<b>100%</b>	<b>65,968,796</b>	<b>100%</b>	<b>2,245,698</b>	<b>100%</b>

(1) Life to Date Purchased Face Value represents the original face amount purchased from sellers and has not been reduced by any adjustments including payments and buybacks.

(2) Original Purchase Price represents the cash paid to sellers to acquire portfolios of defaulted consumer receivables.

We also review the geographic distribution of accounts within a portfolio because we have found that state specific laws and rules can have an effect on the collectability of accounts located there. In addition, economic factors and bankruptcy trends vary regionally and are factored into our maximum purchase price equation.

The following table summarizes our life to date portfolio purchases as of March 31, 2012, by geographic location (amounts in thousands):

Geographic Distribution	No. of Accounts	%	Life to Date Purchased		Original Purchase	
			Face Value <sup>(1)</sup>	%	Price <sup>(2)</sup>	%
California	3,007	11%	\$ 8,689,413	13%	\$ 291,741	13%
Texas	4,252	15	7,491,588	11	199,840	9
Florida	2,259	8	6,306,308	10	205,914	9
New York	1,639	6	3,955,168	6	122,058	5
Pennsylvania	1,032	4	2,445,225	4	82,340	4
Ohio	1,231	4	2,409,340	4	93,776	4
Illinois	1,082	4	2,293,314	3	85,898	4
North Carolina	1,007	4	2,255,337	3	75,909	3
Georgia	927	3	2,191,204	3	87,340	4
New Jersey	661	2	1,801,552	3	64,311	3
Michigan	752	3	1,768,076	3	68,585	3
Arizona	502	2	1,413,070	2	47,386	2
Virginia	753	3	1,404,939	2	52,989	2
Tennessee	607	2	1,373,275	2	52,575	2
Massachusetts	494	2	1,228,619	2	40,885	2
Indiana	461	2	1,142,523	2	48,376	2
Other <sup>(3)</sup>	7,927	25	17,799,845	27	625,775	29
<b>Total:</b>	<b>28,593</b>	<b>100%</b>	<b>65,968,796</b>	<b>100%</b>	<b>2,245,698</b>	<b>100%</b>

(1) Life to Date Purchased Face Value represents the original face amount purchased from sellers and has not been reduced by any adjustments, including payments and buybacks.

Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

- (2) Original Purchase Price represents the cash paid to sellers to acquire portfolios of defaulted consumer receivables.
- (3) Each state included in Other represents less than 2% of the face value of total defaulted consumer receivables.

---

## **Table of Contents**

### **Liquidity and Capital Resources**

Historically, our primary sources of cash have been cash flows from operations, bank borrowings and equity offerings. Cash has been used for acquisitions of finance receivables, corporate acquisitions, repurchase of our common stock, payment of cash dividends, repayments of bank borrowings, purchases of property and equipment and working capital to support our growth.

As of March 31, 2012, cash and cash equivalents totaled \$28.1 million, as compared to \$26.7 million at December 31, 2011. Total debt outstanding on our \$458.5 million line of credit was \$265.0 million as of March 31, 2012, which represents availability of \$193.5 million (subject to the borrowing base and applicable debt covenants).

We have in place forward flow commitments for the purchase of defaulted consumer receivables over the next 12 months of approximately \$212.5 million as of March 31, 2012. Additionally we may enter into new or renewed flow commitments in the next twelve months and close on spot transactions in addition to the aforementioned flow agreements. We believe that funds generated from operations and from cash collections on finance receivables, together with existing cash and available borrowings under our credit agreement would be sufficient to finance our operations, planned capital expenditures, the aforementioned forward flow commitments, and a material amount of additional portfolio purchasing in excess of the currently committed flow amounts during the next twelve months.

We are cognizant of the market fundamentals in the debt purchase and company acquisition market which, because of significant supply and tight capital availability, could cause increased buying opportunities to arise. Accordingly, we filed a \$150 million shelf registration during the third quarter of 2009. We issued \$75.5 million of equity securities under that registration statement during February of 2010 in order to take advantage of market opportunities while retaining the ability to issue up to an additional \$74.5 million of equity or debt securities under the shelf registration statement in the future. The outcome of any future transaction is subject to market conditions. In addition, on April 20, 2012, we closed a series of transactions to exercise a portion of the accordion loan feature of our existing credit thereby increasing the lenders commitments by \$50,950,000, resulting in \$458,450,000 aggregate principal amount available under our line of credit. Refer to the Borrowings section below for additional information on the line of credit.

With the acquisition of a controlling interest in CCB, we have the right to call (purchase) the noncontrolling interest through February 2015. In addition, the noncontrolling interest has the right to put the remainder of the shares to us beginning in March 2012 and ending February 2018. The total maximum amount we would have to pay for the noncontrolling interest in CCB in any scenario is \$22.8 million.

We file income tax returns using the cost recovery method for tax revenue recognition as it relates to our debt purchasing business. We were notified on June 21, 2007 that we were being examined by the IRS for the 2005 tax year. The IRS concluded the audit and on March 19, 2009 issued Form 4549-A, Income Tax Examination Changes, for tax years ended December 31, 2007, 2006 and 2005. The IRS has asserted that cost recovery for tax revenue recognition does not clearly reflect taxable income and that unused line fees paid on credit facilities should be capitalized and amortized rather than taken as a current deduction. On April 22, 2009, we filed a formal protest of the findings contained in the examination report prepared by the IRS. On August 26, 2011, the IRS issued a Notice of Deficiency for the tax years ended December 31, 2007, 2006, and 2005. We subsequently filed a petition in United States Tax Court to which the IRS responded on January 12, 2012. We believe we have sufficient support for the technical merits of our positions and that it is more-likely-than-not that these positions will ultimately be sustained; therefore, a reserve for uncertain tax positions is not necessary for these tax positions. If we are unsuccessful in tax court, we can appeal to the federal Circuit Court of Appeals. If judicial appeals prove unsuccessful, we may ultimately be required to pay the related deferred taxes, any potential interest, and penalties, possibly requiring additional financing from other sources. In accordance with the Internal Revenue Code, underpayments of federal tax accrue interest, compounded daily, at the applicable federal short term rate plus three percentage points. An additional two percentage points applies to large corporate underpayments of \$100,000 or more to periods after the applicable date as defined in the Internal Revenue Code. We file taxes in multiple state jurisdictions; therefore, any underpayment of state tax will accrue interest in accordance with the respective state statute. The deferred tax liability related to revenue recognition on our debt purchasing business is \$195.3 million at March 31, 2012. In 2011, the IRS expanded the audit to include the tax years ended December 31, 2010, 2009 and 2008.



## **Table of Contents**

In forming our tax positions, we consider inputs based on industry practice, tax advice from professionals and drawing similarities of our facts and circumstances to those in established case law (most notably as it relates to revenue recognition, *Underhill* and *Liftin*). These tax positions deal not only with revenue recognition, but also with general tax compliance, including sales and use, franchise, gross receipts, payroll, property and income tax issues, including our tax base and apportionment factors.

A diverse group of companies participate in our industry including distressed debt purchasers, Wall Street hedge funds, small private collection companies and other such investment firms. These participants are diverse in their structure, processes, and profitability. We base our primary tax revenue recognition policy on the nature of the assets that we acquire. We therefore file income tax returns using the cost recovery method for tax revenue recognition as it relates to our debt purchasing business.

Cash generated from operations is dependent upon our ability to collect on our finance receivables. Many factors, including the economy and our ability to hire and retain qualified collectors and managers, are essential to our ability to generate cash flows. Fluctuations in these factors that cause a negative impact on our business could have a material impact on our future cash flows.

Our operating activities provided cash of \$20.1 million and \$43.3 million for the three months ended March 31, 2012 and 2011, respectively. In these periods, cash from operations was generated primarily from net income earned through cash collections and fee income received for the period. The decrease was primarily due to a decrease in deferred tax expense from \$14.1 million for the three months ended March 31, 2011 to \$0.4 million for the three months ended March 31, 2012. This was offset by an increase in net income to \$25.2 million for the three months ended March 31, 2012, from \$23.7 million for the nine months ended March 31, 2011. The remaining changes were due to net changes in other accounts related to our operating activities.

Our investing activities used cash of \$64.2 million and \$37.8 million during the three months ended March 31, 2012 and 2011, respectively. Cash provided by investing activities is primarily driven by cash collections applied to principal on finance receivables. Cash used in investing activities is primarily driven by acquisitions of defaulted consumer receivables, purchases of property and equipment and business acquisitions. The majority of the increase was due to net cash payments for business acquisitions totaling \$48.7 million during the three months ended March 31, 2012, as compared to \$0 during the three months ended March 31, 2011, as well as an increase in acquisitions of finance receivables, which increased from \$106.4 million for the three months ended March 31, 2011 to \$108.2 million for the three months ended March 31, 2012, partially offset by an increase in collections applied to principal on finance receivables from \$70.7 million for the nine three ended March 31, 2011 to \$93.8 million for the three months ended March 31, 2012.

Our financing activities provided cash of \$44.0 million and used cash of \$11.1 million during the three months ended March 31, 2012 and 2011, respectively. Cash is provided by draws on our line of credit, proceeds from equity offerings, proceeds from debt financing and stock option exercises. Cash used in financing activities is primarily driven by principal payments on our line of credit and principal payments on long-term debt. The majority of the increase was due to net cash proceeds received on our line of credit totaling \$45.0 million during the three months ended March 31, 2012, compared to net repayments on our line of credit of \$10.0 million during the three months ended March 31, 2011.

Cash paid for interest was \$2.6 million and \$2.7 million for the three months ended March 31, 2012 and 2011, respectively. Interest was paid on our line of credit and long-term debt. The decrease was primarily due to a decrease in our average borrowings under our revolving credit facility for the three months ended March 31, 2012 compared to the same period in 2011 partially offset by an increase in our weighted average interest rate, which increased to 3.8% for the three months ended March 31, 2012, compared to 3.6% for the three months ended March 31, 2011. Cash paid for income taxes was \$12.5 million and \$0 for the three months ended March 31, 2012 and 2011, respectively. The increase was primarily due to an increase in estimated taxable income as of March 31, 2012 for the year ending December 31, 2011 and a projected current tax loss as of March 31, 2011 for the year ended December 31, 2010.

**Table of Contents**

*Borrowings*

On December 20, 2010, we entered into a credit agreement with Bank of America, N.A., as administrative agent, and a syndicate of lenders named therein (the Credit Agreement). Under the terms of the Credit Agreement, the credit facility includes an aggregate principal amount available of \$407.5 million (subject to the borrowing base and applicable debt covenants), consisting of a \$50 million fixed rate loan that matures on May 4, 2012, which was transferred from our then existing credit agreement, and a \$357.5 million revolving credit facility that matures on December 20, 2014. The revolving credit facility will be automatically increased by \$50 million upon the maturity and repayment of the fixed rate loan. The fixed rate loan bears interest at a rate of 6.8% per annum, payable monthly in arrears. The revolving loans accrue interest, at our option, at either the base rate plus 1.75% per annum or the Eurodollar rate (as defined) for the applicable term plus 2.75% per annum. The base rate is the highest of (a) the Federal Funds Rate plus 0.50%, (b) Bank of America's prime rate, and (c) the Eurodollar rate plus 1.00%. Interest is payable on base rate loans quarterly in arrears and on Eurodollar loans in arrears on the last day of each interest period or, if such interest period exceeds three months, every three months. Our revolving credit facility includes a \$20 million swingline loan sublimit and a \$20 million letter of credit sublimit. It also contains an accordion loan feature that allows us to request an increase of up to \$142.5 million in the amount available for borrowing under the revolving credit facility, whether from existing or new lenders, subject to the terms of the Credit Agreement. No existing lender is obligated to increase its commitment. On April 20, 2012, we closed a series of transactions to exercise a portion of the accordion loan feature of our existing credit facility with our administrative agent and our syndicate of lenders, thereby increasing the lenders' commitments by \$50,950,000, resulting in \$458,450,000 aggregate principal amount available under our line of credit. Our existing lenders under the Credit Agreement provided \$40,950,000 of this increase, and \$10,000,000 was provided by a new lender which is now a party to the Credit Agreement. The Company may request additional increases of up to \$91,550,000 under its credit facility. The Credit Agreement is secured by a first priority lien on substantially all of our assets. The Credit Agreement contains restrictive covenants and events of default include the following:

borrowings may not exceed 30% of the ERC of all its eligible domestic asset pools plus 75% of its eligible accounts receivable;

the consolidated leverage ratio (as defined in the Credit Agreement) cannot exceed 2.0 to 1.0 as of the end of any fiscal quarter;

consolidated Tangible Net Worth (as defined in the Credit Agreement) must equal or exceed \$309,452,000 plus 50% of positive consolidated net income for each fiscal quarter beginning December 31, 2010, plus 50% of the net proceeds of any equity offering;

capital expenditures during any fiscal year cannot exceed \$20 million;

cash dividends and distributions during any fiscal year cannot exceed \$20 million;

stock repurchases during the term of the agreement cannot exceed \$100 million;

permitted acquisitions (as defined in the Credit Agreement) during any fiscal year cannot exceed \$100 million;

the Company must maintain positive consolidated income from operations (as defined in the Credit Agreement) during any fiscal quarter; and

restrictions on changes in control.

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

The revolving credit facility also bears an unused commitment fee of 0.375% per annum, payable quarterly in arrears.

At March 31, 2012, all of our borrowings under our revolving credit facility consisted of 30-day Eurodollar rate loans and base rate loans with a weighted average annual interest rate equal to 2.99%.

**Table of Contents**

We had \$265.0 million and \$220.0 million of borrowings outstanding on our credit facility as of March 31, 2012 and December 31, 2011, respectively, of which \$50 million represented borrowings under the non-revolving fixed rate loan at both dates.

We were in compliance with all covenants of our credit facility as of March 31, 2012 and December 31, 2011.

*Undistributed Earnings of Foreign Subsidiaries*

We intend to use remaining accumulated and future undistributed earnings of foreign subsidiaries to expand operations outside the United States; therefore, such undistributed earnings of foreign subsidiaries are considered to be indefinitely reinvested outside the United States. Accordingly, no provision for U.S. federal and state income tax has been provided thereon. If management intentions change and eligible undistributed earnings of foreign subsidiaries are repatriated, taxes would be accrued and paid on such earnings.

*Stockholders' Equity*

Stockholders' equity was \$620.7 at March 31, 2012 and \$595.5 million at December 31, 2011. The increase was primarily attributable to \$25.5 million in net income attributable to PRA during the first three months of 2012.

**Contractual Obligations**

Our contractual obligations as of March 31, 2012 were as follows (amounts in thousands):

Contractual Obligations	Total	Payments due by period			
		Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Operating Leases	\$ 23,151	\$ 4,490	\$ 8,604	\$ 6,405	\$ 3,652
Line of Credit <sup>(1)</sup>	286,698	8,149	278,549		
Long-term Debt	968	553	415		
Purchase Commitments <sup>(2) (3)</sup>	240,708	225,508	15,200		
Employment Agreements	15,672	8,187	7,394	91	
Total	\$ 567,197	\$ 246,887	\$ 310,162	\$ 6,496	\$ 3,652

(1) To the extent that a balance is outstanding on our line of credit, the revolving portion (\$210 million) would be due in December 2014 and the non-revolving fixed rate sub-limit portion (\$50 million) would be due in May 2012. Upon maturity of the fixed rate portion, the revolving credit facility will be automatically increased by \$50 million. Therefore, for purposes of this table and the related interest calculations, the assumed maturity of the fixed rate sublimit is the same as the existing revolving portion or December 2014. This amount also includes estimated interest and unused line fees due on the line of credit for both the fixed rate and variable rate components. This estimate also assumes that the balance on the line of credit remains constant from the March 31, 2012 balance of \$260.0 million and the balance is paid in full at its respective maturity.

(2) This amount includes the maximum remaining amount to be purchased under forward flow contracts for the purchase of charged-off consumer debt in the amount of approximately \$212.5 million.

(3) This amount includes the maximum remaining purchase price of \$22.8 million to be paid to acquire the noncontrolling interest of CCB.

**Off-Balance Sheet Arrangements**

We do not have any off balance sheet arrangements as defined by Regulation S-K 303(a)(4) promulgated under the Securities Exchange Act of 1934 (the Exchange Act).

**Recent Accounting Pronouncements**

## Edgar Filing: PORTFOLIO RECOVERY ASSOCIATES INC - Form 10-Q

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. The amendments in ASU 2011-04 generally represent clarification of Topic 820, but also include instances where a

---

## **Table of Contents**

particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and International Financial Reporting Standards ( IFRS ). The provisions of ASU 2011-04 are effective prospectively for interim and annual periods beginning after December 15, 2011. Early adoption is prohibited. We adopted ASU 2011-04 on January 1, 2012, and have included the required disclosures in our notes to our consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220)* to amend its accounting guidance on the presentation of other comprehensive income ( OCI ) in an entity's financial statements. The amended guidance eliminates the option to present the components of OCI as part of the statement of changes in stockholders equity and provides two options for presenting OCI: in a statement included in the income statement or in a separate statement immediately following the income statement. The amendments do not change the guidance for the items that have to be reported in OCI or when an item of OCI has to be moved into net income. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We adopted ASU 2011-05 on January 1, 2012, and have included the required disclosures in our consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, *Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment* to amend the accounting guidance on goodwill impairment testing. The amended guidance reduces the complexity and costs of goodwill impairment testing by allowing an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it should calculate the fair value of a reporting unit. The amended guidance also improves previous guidance by expanding upon the examples of events and circumstances that an entity should consider between annual impairment tests in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The amendments are effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. We adopted ASU 2011-08 on January 1, 2012 which had no material impact on our consolidated financial statements.

### **Critical Accounting Policies**

Our consolidated financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles. The preparation of these financial statements requires estimation and judgment that affect the reported amounts of revenues, expenses, assets, and liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The following critical accounting policies are a subset of our significant accounting policies described in Note 1 to the consolidated financial statements. These critical accounting policies affect significant areas of our financial statements and involve judgment and estimates. If these estimates differ significantly from actual results, the impact on our consolidated financial statements may be material.

Management believes our critical accounting policies and estimates are those related to revenue recognition, valuation of acquired intangibles and goodwill, and income taxes. Management believes these policies to be critical because they are both important to the portrayal of our financial condition and results, and because they require management to make judgments and estimates about matters that are inherently uncertain. Our senior management has reviewed these critical accounting policies and related disclosures with the Audit Committee of our Board of Directors.

#### *Revenue Recognition*

##### Finance Receivables:

We account for our investment in finance receivables under the guidance of ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality (ASC 310-30)*. We acquire portfolios of accounts that have experienced deterioration of credit quality between origination and our acquisition of the accounts. The amount paid for a portfolio reflects our determination that it is probable we will be unable to collect all amounts due according to an account's contractual terms. At acquisition, we review the accounts to determine whether there is evidence of deterioration of credit quality since origination, and if it is probable that we will be unable to collect all

**Table of Contents**

amounts due according to the loan's contractual terms. If both conditions exist, we then determine whether each such account is to be accounted for individually or whether such accounts will be assembled into pools based on common risk characteristics. We consider expected prepayments and estimate the amount and timing of undiscounted expected principal, interest and other cash flows (expected at acquisition) for each acquired portfolio based on our proprietary models, and then subsequently aggregate portfolios of accounts into pools. We determine the excess of the pool's scheduled contractual principal and contractual interest payments over all cash flows expected at acquisition as an amount that should not be accreted (nonaccretable difference). The remaining amount, representing the excess of the pool's cash flows expected to be collected over the amount paid, is accreted into income recognized on finance receivables over the remaining estimated life of the pool (accretable yield). ASC 310-30 requires that the excess of the contractual cash flows over expected cash flows, based on our estimates derived from our proprietary collection models, not be recognized as an adjustment of revenue or expense or on the balance sheet.

Under ASC 310-30 static pools of accounts may be established. These pools are aggregated based on certain common risk criteria. Each static pool is recorded at cost, which includes certain direct costs of acquisition paid to third parties, and is accounted for as a single unit for the recognition of income, payments applied to principal and loss provision. Once a static pool is established for a calendar quarter, individual receivable accounts are not added to the pool (unless replaced by the seller) or removed from the pool (unless sold or returned to the seller). ASC 310-30, utilizing the interest method, initially freezes the yield, estimated when the accounts are purchased as the basis for subsequent impairment testing. The yield is estimated and periodically recalculated based on the timing and amount of anticipated cash flows using our proprietary collection models. Income on finance receivables is accrued quarterly based on each static pool's effective yield. Significant increases in expected future cash flows may be recognized prospectively, through an upward adjustment of the yield, over a pool's remaining life. Any increase to the yield then becomes the new benchmark for impairment testing. Under ASC 310-30, rather than lowering the estimated yield if the collection estimates are not received or projected to be received, the carrying value of a pool would be written down to maintain the then current yield and is shown as a reduction in revenue in the consolidated income statements with a corresponding valuation allowance offsetting finance receivables, net, on the consolidated balance sheets. Quarterly cash flows greater than the interest accrual will reduce the carrying value of the static pool. This reduction in carrying value is defined as payments applied to principal (also referred to as principal amortization). Likewise, cash flows that are less than the interest accrual will accrete the carrying balance. Generally, we do not record accretion in the first six to twelve months of the estimated life of the pool; accordingly, we utilize either the cost recovery method or cash method when necessary to prevent accretion as permitted by ASC 310-30. Under the cash method, revenue is recognized as it would be under the interest method up to the amount of cash collections. Under the cost recovery method, no revenue is recognized until we have fully collected the cost of the pool. A pool can become fully amortized (zero carrying balance on the balance sheet) while still generating cash collections. In this case, all cash collections are recognized as revenue when received. Additionally, we use the cost recovery method when collections on a particular pool of accounts cannot be reasonably predicted. These cost recovery pools are not aggregated with other pools. Under the cost recovery method, no revenue is recognized until we have fully collected the cost of the pool, or until such time that we consider the collections to be probable and estimable and begin to recognize income based on the interest method as described above.

We establish valuation allowances, if necessary, for acquired accounts subject to ASC 310-10. Valuation allowances are established only subsequent to acquisition of the accounts.

We implement the accounting for income recognized on finance receivables under ASC 310-30 as follows. We create each accounting pool using our projections of estimated cash flows and expected economic life. We then compute the effective yield that fully amortizes the pool to the end of its expected economic life based on the current projections of estimated cash flows. As actual cash flow results are recorded, we balance those results to the data contained in our proprietary models to ensure accuracy, then review each pool watching for trends, actual performance versus projections and curve shape (a graphical depiction of the timing of cash flows), sometimes re-forecasting future cash flows utilizing our statistical models. The review process is primarily performed by our finance staff; however, our operational and statistical staff are also involved, providing updated statistical input and cash projections to the finance staff. To the extent there is overperformance, we will either increase the yield or release the allowance and consider increasing future cash projections, if persuasive evidence indicates that the overperformance is considered to be a significant betterment. If the overperformance is considered more of an acceleration of cash flows (a timing difference), we will adjust estimated future cash flows downward which effectively extends the amortization period, or take no action at all if the amortization period is reasonable and falls

**Table of Contents**

within the pools' expected economic life. In either case, yield may or may not be increased due to the time value of money (accelerated cash collections). To the extent there is underperformance, we will record an allowance if the underperformance is significant and will also consider revising estimated future cash flows based on current period information, or take no action if the pool's amortization period is reasonable and falls within the currently projected economic life.

**Fee Income:**

We utilize the provisions of ASC Topic 605-45, *Principal Agent Considerations* (ASC 605-45), to account for fee income revenue from our fee-for-service subsidiaries. ASC 605-45 requires an analysis to be completed to determine if certain revenues should be reported gross or reported net of their related operating expense. This analysis includes an assessment of who retains inventory/credit risk, controls vendor selection, establishes pricing and remains the primary obligor on the transaction. Each of these factors was considered to determine the correct method of recognizing revenue from our subsidiaries.

Our skip tracing subsidiary utilizes both gross and net reporting under ASC 605-45. We generate revenue by working an account and successfully locating a customer for our client. An *investigative fee* is received for these services. In addition, we incur *agent expenses* where we hire a third-party collector to effectuate repossession. In many cases we have an arrangement with our client which allows us to bill the client for these fees. We have determined these fees to be gross revenue based on the criteria in ASC 605-45 and they are recorded as such in the line item *Fee income*, because we are primarily liable to the third party collector. There is a corresponding expense in *Agent fees* for these pass-through items. We also incur fees to release liens on the repossessed collateral. These lien-release fees are netted in the line *Agent fees*.

Our government processing and collection business' primary source of income is derived from servicing taxing authorities in several different ways: processing all of their tax payments and tax forms, collecting delinquent taxes, identifying taxes that are not being paid and auditing tax payments. The processing and collection pieces are standard commission based billings or fee-for-service transactions. When an audit is conducted, there are two components. The first component is a billing for the hours incurred to conduct the audit. This billing is marked up from the actual costs incurred. The gross billing is a component of the line item *Fee income* and the expense is included in the line item *Compensation and employee services*. The second component is expenses incurred while conducting the audit. Most jurisdictions will reimburse us for direct expenses incurred for the audit including such items as travel and meals. The billed amounts are included in the line item *Fee income* and the expense component is included in its appropriate expense category, generally, *Other operating expenses*.

Our claims administration and payment processing business utilizes net reporting under ASC 605-45. We generate revenue by filing claims with the class action claims administrator on behalf of our clients and receiving the related settlement payment. Under SEC Staff Accounting Bulletin 104 (SAB 104), we have determined that our fee is not earned until we have received the settlement funds. When a payment is received from the claims administrator for settlement of a lawsuit, the fee is recorded on a net basis as revenue and included in the line item *Fee income*. The balance of the received amounts is recorded as a liability and included in the line item *Accounts payable*.

*Valuation of Acquired Intangibles and Goodwill*

In accordance with ASC Topic 350, *Intangibles - Goodwill and Other* (ASC 350), we amortize intangible assets over their estimated useful lives. Goodwill, pursuant to ASC 350, is not amortized but rather is reviewed for impairment annually or earlier if indicators of potential impairment exist. The review of goodwill for potential impairment is highly subjective and requires that: (1) goodwill is allocated to various reporting units of our business to which it relates; and (2) we estimate the fair value of those reporting units to which the goodwill relates and then determine the book value of those reporting units. If the estimated fair value of reporting units with allocated goodwill is determined to be less than their book value, we are required to estimate the fair value of all identifiable assets and liabilities of those reporting units in a manner similar to a purchase price allocation for an acquired business. This requires independent valuation of certain unrecognized assets. Once this process is complete, the amount of goodwill impairment, if any, can be determined.



**Table of Contents***Income Taxes*

We follow the guidance of FASB ASC Topic 740 Income Taxes (ASC 740) as it relates to the provision for income taxes and uncertainty in income taxes. Accordingly, we record a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with ASC 740, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax basis of assets and liabilities, and for operating losses and tax credit carry-forwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The evaluation of a tax position in accordance with the guidance is a two-step process. The first step is recognition: the enterprise determines whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the enterprise should presume that the position will be examined by the appropriate taxing authority that would have full knowledge of all relevant information. The second step is measurement: a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. We record interest and penalties related to unrecognized tax benefits as a component of income tax expense.

We utilize the cost recovery method of income recognition for tax purposes. We believe cost recovery to be an acceptable method for companies in the bad debt purchasing industry, as under the cost recovery method, for tax purposes, collections on finance receivables are applied first to principal to reduce the finance receivables to zero before any income is recognized.

In the event that all or part of the deferred tax assets are determined not to be realizable in the future, a valuation allowance would be established and charged to earnings in the period such determination is made. Similarly, if we subsequently realize deferred tax assets that were previously determined to be unrealizable, the respective valuation allowance would be reversed, resulting in a positive adjustment to earnings or a decrease in goodwill in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with our expectations could have a material impact on our results of operations and financial position.

**Item 3. Quantitative and Qualitative Disclosure About Market Risk****Interest Rate Risk**

We are subject to interest rate risk with our variable rate credit line. We assess this interest rate risk by estimating the increase in interest expense that would occur due to an increase in short-term interest rates. The average borrowings on our variable rate credit line were \$214.6 million and \$249.6 million for the three months ended March 31, 2012 and 2011, respectively. Assuming a 200 basis point increase in interest rates, for example, interest expense would have increased by \$1.1 million and \$1.2 million for the three months ended March 31, 2012 and 2011. As of March 31, 2012 and December 31, 2011, we had \$265.0 million and \$220.0 million, respectively, of variable rate debt outstanding on our credit lines. We do not have any other variable rate debt outstanding as of March 31, 2012. We had no interest rate hedging programs in place for the three months ended March 31, 2012 and 2011. Significant increases in future interest rates on the variable rate credit line could lead to a material decrease in future earnings assuming all other factors remained constant.

**Currency Exchange Risk**

In the first quarter of 2012, we acquired MHH. MHH conducts business in British pounds, but we report our financial results in U.S. dollars. Therefore, as a result of the MHH acquisition, we face exposure to fluctuations in

## **Table of Contents**

currency exchange rates. Significant fluctuations in exchange rates between the U.S. dollar and the British pound may adversely affect our net income. We may or may not implement a hedging program related to currency exchange rate fluctuations.

### **Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures.* We maintain disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial and Administrative Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, controls may become inadequate because of changes in conditions and the degree of compliance with the policies or procedures may deteriorate. We conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial and Administrative Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and Chief Financial and Administrative Officer have concluded that, as of March 31, 2012, our disclosure controls and procedures were effective.

*Changes in Internal Control Over Financial Reporting.* There was no change in our internal control over financial reporting that occurred during the quarter ended March 31, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

We are from time to time subject to routine legal claims and proceedings, most of which are incidental to the ordinary course of our business. We initiate lawsuits against customers and are occasionally countersued by them in such actions. Also, customers, either individually, as members of a class action, or through a governmental entity on behalf of customers, may initiate litigation against us in which they allege that we have violated a state or federal law in the process of collecting on an account. From time to time, other types of lawsuits are brought against us.

No legal proceedings were commenced during the period covered by this report that the Company believes could reasonably be expected to have a material adverse effect on its financial condition, results of operations and cash flows, nor have there been any material developments with respect to legal proceedings previously disclosed with respect to prior periods

### **Item 1A. Risk Factors**

An investment in our common stock involves a high degree of risk. You should carefully consider the specific risk factors listed under Part I, Item 1A of our 2011 Annual Report on Form 10-K filed on February 28, 2012, together with all other information included or incorporated in our reports filed with the SEC. Any such risks may materialize, and additional risks not known to us, or that we now deem immaterial, may arise. In such event, our business, financial condition, results of operations or prospects could be materially adversely affected. If that occurs, the market price of our common stock could fall, and you could lose all or part of your investment.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds***Share Repurchase Program*

On February 2, 2012, the Company's Board of Directors authorized a share repurchase program to purchase up to \$100,000,000 of the Company's outstanding shares of common stock on the open market. The following table provides information about the Company's common stock purchased during the first quarter of 2012.

Month Ended	Total Number of Shares Purchased	Average Price Paid per Share	Maximum Remaining Purchase Price for Share Repurchases Under the Plan
March 31, 2012	30,600	\$ 68.02	\$ 97,918,610
<b>Total</b>	30,600	\$ 68.02	\$ 97,918,610

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

31.1	Section 302 Certifications of Chief Executive Officer.
31.2	Section 302 Certifications of Chief Financial and Administrative Officer.
32.1	Section 906 Certifications of Chief Executive Officer and Chief Financial and Administrative Officer.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

**Table of Contents**

**SIGNATURES**

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

PORTFOLIO RECOVERY ASSOCIATES, INC.  
(Registrant)

Date: May 10, 2012

By: /s/ Steven D. Fredrickson  
Steven D. Fredrickson  
Chief Executive Officer, President and Chairman of the Board of  
Directors (Principal Executive Officer)

Date: May 10, 2012

By: /s/ Kevin P. Stevenson  
Kevin P. Stevenson  
Chief Financial and Administrative Officer,  
Executive Vice President, Treasurer and Assistant Secretary  
(Principal Financial and Accounting Officer)