PORTFOLIO RECOVERY ASSOCIATES INC
Form 10-Q
November 09, 2010

Table of Contents

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

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2010.**

o **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)*

| Delaware | 75-3078675 |
|---|---|
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification No.)* |
| 120 Corporate Boulevard, Norfolk, Virginia | 23502 |
| *(Address of principal executive offices)* | *(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 þ NO o

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 o NO o

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

| Large accelerated filer þ | Accelerated filer o | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller Reporting Company o |
|---|---|---|---|

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o NO þ

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 November 3, 2010 |
| --- | --- |
| Common Stock, $0.01 par value | 17,061,914 |

**PORTFOLIO RECOVERY ASSOCIATES, INC.**
**INDEX**


| | Page(s) |
|---|---|
| **PART I. FINANCIAL INFORMATION** | |
| **Item 1.** Financial Statements | 3 |
| Consolidated Balance Sheets (unaudited) as of September 30, 2010 and December 31, 2009 | 3 |
| Consolidated Income Statements (unaudited) For the three and nine months ended September 30, 2010 and 2009 | 4 |
| Consolidated Statement of Changes in Stockholders Equity and Comprehensive Income (unaudited) For the nine months ended September 30, 2010 | 5 |
| Consolidated Statements of Cash Flows (unaudited) For the nine months ended September 30, 2010 and 2009 | 6 |
| Notes to Consolidated Financial Statements (unaudited) | 7-24 |
| **Item 2.** Management s Discussion and Analysis of Financial Condition and Results of Operations | 25-49 |
| **Item 3.** Quantitative and Qualitative Disclosure About Market Risk | 49 |
| **Item 4.** Controls and Procedures | 49-50 |
| **PART II. OTHER INFORMATION** | |
| **Item 1.** Legal Proceedings | 50 |
| **Item 1A.** Risk Factors | 51 |
| **Item 2.** Unregistered Sales of Equity Securities and Use of Proceeds | 51 |
| **Item 3.** Defaults Upon Senior Securities | 51 |
| **Item 4.** Other Information | 51 |
| **Item 5.** Exhibits | 51 |
| **SIGNATURES** | 52 |

EX-31.1
EX-31.2
EX-32.1
EX-101 INSTANCE DOCUMENT
EX-101 SCHEMA DOCUMENT
EX-101 CALCULATION LINKBASE DOCUMENT
EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT

EX-101 DEFINITION LINKBASE DOCUMENT

2

Table of Contents

**Part I. FINANCIAL INFORMATION**
**Item 1. Financial Statements**

**PORTFOLIO RECOVERY ASSOCIATES, INC.**
**CONSOLIDATED BALANCE SHEETS**
**September 30, 2010 and December 31, 2009**
**(unaudited)**
**(Amounts in thousands, except per share amounts)**

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | $ 20,297 | $ 20,265 |
| Finance receivables, net | 807,239 | 693,462 |
| Accounts receivable, net | 7,789 | 9,169 |
| Income taxes receivable | 2,603 | 4,460 |
| Property and equipment, net | 22,794 | 21,864 |
| Goodwill | 61,665 | 29,299 |
| Intangible assets, net | 19,945 | 10,756 |
| Other assets | 5,405 | 5,158 |
| Total assets | $ 947,737 | $ 794,433 |
| **Liabilities and Stockholders Equity** | | |
| Liabilities: | | |
| Accounts payable | $ 5,739 | $ 4,108 |
| Accrued expenses and other liabilities | 6,922 | 4,506 |
| Accrued payroll and bonuses | 10,447 | 11,633 |
| Deferred tax liability | 151,638 | 117,206 |
| Line of credit | 288,500 | 319,300 |
| Long-term debt | 998 | 1,499 |
| Derivative instrument | 537 | 701 |
| Total liabilities | 464,781 | 458,953 |
| Commitments and contingencies (Note 14) | | |
| Redeemable noncontrolling interest | 14,531 | |
| Stockholders equity: | | |
| Preferred stock, par value $0.01, authorized shares, 2,000, issued and outstanding shares - 0 | | |
| Common stock, par value $0.01, authorized shares, 30,000, 17,061 issued and outstanding shares at September 30, 2010, and 15,596 issued and 15,514 | 171 | 155 |

| | | | | |
|---|---|---|---|---|
| outstanding shares at December 31, 2009 | | | | |
| Additional paid-in capital | | 162,418 | | 82,400 |
| Retained earnings | | 306,164 | | 253,353 |
| Accumulated other comprehensive loss, net of taxes | | (328) | | (428) |
| Total stockholders equity | | 468,425 | | 335,480 |
| Total liabilities and stockholders equity | $ | 947,737 | $ | 794,433 |

*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 and nine months ended September 30, 2010 and 2009**
**(unaudited)**
**(Amounts in thousands, except per share amounts)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** |
| Revenues: | | | | |
| Income recognized on finance receivables, net | $ 80,026 | $ 54,336 | $ 224,897 | $ 159,650 |
| Fee income | 15,518 | 14,229 | 47,054 | 48,225 |
| Total revenues | 95,544 | 68,565 | 271,951 | 207,875 |
| Operating expenses: | | | | |
| Compensation and employee services | 31,213 | 26,844 | 91,725 | 79,940 |
| Legal and agency fees and costs | 16,748 | 11,296 | 43,573 | 34,460 |
| Outside fees and services | 3,470 | 2,284 | 9,454 | 6,854 |
| Communications | 4,000 | 3,472 | 13,160 | 11,157 |
| Rent and occupancy | 1,362 | 1,270 | 3,912 | 3,515 |
| Depreciation and amortization | 3,294 | 2,269 | 9,050 | 6,874 |
| Other operating expenses | 2,634 | 2,341 | 7,488 | 6,565 |
| Total operating expenses | 62,721 | 49,776 | 178,362 | 149,365 |
| Income from operations | 32,823 | 18,789 | 93,589 | 58,510 |
| Other income and (expense): | | | | |
| Interest income | | | 35 | 3 |
| Interest expense | (2,178) | (1,964) | (6,535) | (5,891) |
| Income before income taxes | 30,645 | 16,825 | 87,089 | 52,622 |
| Provision for income taxes | 11,888 | 6,729 | 33,847 | 20,730 |
| Net income | $ 18,757 | $ 10,096 | $ 53,242 | $ 31,892 |
| Less net income attributable to redeemable noncontrolling interest | (276) | | (431) | |
| | $ 18,481 | $ 10,096 | $ 52,811 | $ 31,892 |

| | | | | |
|---|---|---|---|---|
| Net income attributable to Portfolio Recovery Associates, Inc. | | | | |
| Net income per common share attributable to Portfolio Recovery Associates, Inc: | | | | |
| Basic | $ 1.08 | $ 0.65 | $ 3.15 | $ 2.07 |
| Diluted | $ 1.08 | $ 0.65 | $ 3.15 | $ 2.07 |
| Weighted average number of shares outstanding: | | | | |
| Basic | 17,058 | 15,466 | 16,740 | 15,392 |
| Diluted | 17,093 | 15,502 | 16,792 | 15,428 |

*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 AND COMPREHENSIVE INCOME**
**For the nine months ended September 30, 2010**
**(unaudited)**
**(Amounts in thousands)**

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Loss, Net of Taxes | Total Stockholders Equity |
|---|---|---|---|---|---|
| Balance at December 31, 2009 | $ 155 | $ 82,400 | $ 253,353 | $ (428) | $ 335,480 |
| Net income | | | 52,811 | | 52,811 |
| Net unrealized change in: | | | | | |
| Interest rate swap derivative, net of tax | | | | 100 | 100 |
| Comprehensive income | | | | | 52,911 |
| Exercise of stock options and vesting of nonvested shares | 2 | 55 | | | 57 |
| Proceeds from stock offering, net of offering costs | 14 | 71,674 | | | 71,688 |
| Amortization of share-based compensation | | 3,114 | | | 3,114 |
| Income tax benefit from share-based compensation | | 225 | | | 225 |
| Issuance of common stock for acquisition | | 4,950 | | | 4,950 |
| Balance at September 30, 2010 | $ 171 | $ 162,418 | $ 306,164 | $ (328) | $ 468,425 |

*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 nine months ended September 30, 2010 and 2009**
**(unaudited)**
**(Amounts in thousands)**

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| Cash flows from operating activities: | | |
| Net income | $ 53,242 | $ 31,892 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of share-based compensation | 3,114 | 3,240 |
| Depreciation and amortization | 9,050 | 6,874 |
| Deferred tax expense | 34,368 | 22,000 |
| Changes in operating assets and liabilities: | | |
| Other assets | (244) | (14) |
| Accounts receivable | 1,380 | 1,369 |
| Accounts payable | 1,631 | 520 |
| Income taxes | 1,857 | (2,306) |
| Accrued expenses | 194 | (851) |
| Accrued payroll and bonuses | (1,186) | 1,443 |
| Net cash provided by operating activities | 103,406 | 64,167 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (6,162) | (3,079) |
| Acquisition of finance receivables, net of buybacks | (273,858) | (210,116) |
| Collections applied to principal on finance receivables | 160,081 | 113,067 |
| Business acquisitions, net of cash acquired | (23,000) | |
| Contingent payments made for business acquisition | (104) | (100) |
| Net cash used in investing activities | (143,043) | (100,228) |
| Cash flows from financing activities: | | |
| Proceeds from exercise of options | 57 | 1,630 |
| Income tax benefit from share-based compensation | 225 | 746 |
| Payments of liability-classified contingent consideration | (1,000) | |
| Proceeds from line of credit | 131,000 | 84,500 |
| Principal payments on line of credit | (161,800) | (46,500) |
| Proceeds from stock offering, net of offering costs | 71,688 | |
| Proceeds from long-term debt | | 2,036 |
| Principal payments on long-term debt | (501) | (373) |
| Principal payments on capital lease obligations | | (5) |

| | | |
|---|---|---|
| Net cash provided by financing activities | 39,669 | 42,034 |
| Net increase in cash and cash equivalents | 32 | 5,973 |
| Cash and cash equivalents, beginning of period | 20,265 | 13,901 |
| Cash and cash equivalents, end of period | $ 20,297 | $ 19,874 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | $ 6,508 | $ 6,028 |
| Cash paid for income taxes | 89 | 321 |
| Noncash investing and financing activities: | | |
| Net unrealized change in fair value of derivative instrument | $ 164 | $ (655) |
| Common stock issued for acquisition | 4,950 | 1,170 |

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

Table of Contents

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

**1. Organization and Business:**

Portfolio Recovery Associates, LLC ( PRA ) was formed on March 20, 1996. Portfolio Recovery Associates, Inc. ( PRA Inc ) was formed in August 2002. On November 8, 2002, PRA Inc completed its initial public offering ( IPO ) of common stock. In connection with the IPO, all of the membership units and warrants of PRA were exchanged on a one to one basis for shares of a single class of common stock of PRA Inc and warrants to purchase shares of PRA Inc common stock, respectively. PRA Inc owns all outstanding membership units of PRA, PRA Holding I, LLC ( PRA Holding I ), PRA Holding II, LLC ( PRA Holding II ), PRA Holding III, LLC ( PRA Holding III ), PRA Receivables Management, LLC (formerly d/b/a Anchor Receivables Management) ( Anchor ), PRA Location Services, LLC (d/b/a IGS Nevada) ( IGS ), PRA Government Services, LLC (d/b/a RDS) ( RDS ) and MuniServices, LLC (d/b/a PRA Government Services) ( MuniServices ). On March 15, 2010, PRA Inc acquired 62% of the membership units of Claims Compensation Bureau, LLC ( CCB ). The business of PRA Inc, a Delaware corporation, and its subsidiaries (collectively, the Company ) revolves around the detection, collection, and processing of both unpaid and normal-course receivables originally owed to credit grantors, governments, retailers and others. The Company s primary business is the purchase, collection and management of portfolios of defaulted consumer receivables. These accounts are purchased from sellers of finance receivables and collected by a highly skilled staff whose purpose is to locate and contact customers and arrange payment or resolution of their debts. The Company, through its Litigation Department, collects accounts judicially, either by using its own attorneys or by contracting with independent attorneys throughout the country through whom the Company takes legal action to satisfy consumer debts. The Company also services receivables on behalf of clients on either a commission or transaction-fee basis. Clients include entities in the financial services, auto, retail, utility, health care and government sectors. Services provided to these clients include obtaining location information for clients in support of their collection activities (known as skip tracing), and the management of both delinquent and non-delinquent receivables for government entities. In addition, through its newly acquired CCB subsidiary, the Company provides class action claims settlement recovery services and related payment processing to its corporate clients.

The consolidated financial statements of the Company include the accounts of PRA Inc, PRA, PRA Holding I, PRA Holding II, PRA Holding III, Anchor, IGS, RDS, MuniServices and CCB. Under the guidance of 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, receivables management, based on similarities among the operating units including homogeneity of services, service delivery methods and use of technology.

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 September 30, 2010, its consolidated income statements for the three and nine months ended September 30, 2010 and 2009, its consolidated statement of changes in stockholders equity and comprehensive income for the nine months ended September 30, 2010, and its consolidated statements of cash flows for the nine months ended September 30, 2010 and 2009. The consolidated income statement of the Company for the nine months ended September 30, 2010 may not be indicative of future results. 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, 2009.

**2. Finance Receivables, net:**

The Company s principal business consists of the acquisition and collection of pools of accounts that have experienced deterioration of credit quality between origination and the Company s acquisition of the accounts. The amount paid for any pool reflects the Company s determination that it is probable the Company will be unable to

7

Table of Contents

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

collect all amounts due according to an account s contractual terms. At acquisition, the Company reviews the portfolio both by account and aggregate pool 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 account s contractual terms. If both conditions exist, the Company 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 for each acquired portfolio and subsequently aggregates pools of accounts. 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) based on the Company s proprietary acquisition models. 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 life of the pool (accretable yield).

The Company accounts for its investment in finance receivables under the guidance of FASB ASC Topic 310-30 Loans and Debt Securities Acquired with Deteriorated Credit Quality ( ASC 310-30 ). 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, principal payments 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 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. ASC 310-30, utilizing the interest method, initially freezes the yield estimated when the accounts are purchased as the basis for subsequent impairment testing. Significant increases in actual, or expected future cash flows may be recognized prospectively through an upward adjustment of the yield over a portfolio 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 sheet. Income on finance receivables is accrued quarterly based on each static pool s effective yield. 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 finance receivable amortization). Likewise, cash flows that are less than the interest accrual will accrete the carrying balance. The Company generally does not allow accretion in the first six to twelve months; accordingly, the Company utilizes either the cost recovery method or cash method when necessary to prevent accretion as permitted by ASC 310-30. The yield is estimated and periodically recalculated based on the timing and amount of anticipated cash flows using the Company s proprietary collection models. 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. Under the cash method, revenue is recognized as it would be under the interest method up to the amount of cash collections. 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 portfolios. Under the cost recovery method, no revenue is recognized until the Company has fully collected the cost of the portfolio, 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 September 30, 2010 and December 31, 2009, the Company had unamortized purchased principal (purchase price) in pools accounted for under the cost recovery method of $1.8 million and $2.9 million, respectively.

The Company establishes valuation allowances, if necessary, for acquired accounts subject to ASC 310-30 to reflect only those losses incurred after acquisition (that is, the present value of cash flows initially expected at

acquisition that are no longer expected to be collected). Valuation allowances are established only subsequent to acquisition of the accounts. At September 30, 2010 and December 31, 2009, the Company had an allowance against its finance receivables of $70,965,000 and $51,255,000, respectively.

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

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 using the interest method. 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 accounting 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; additionally, the Company s operational and statistical staffs may also be involved. 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, the 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.

The Company capitalizes certain fees paid to third parties related to the direct acquisition of a portfolio of accounts. These fees are added to the acquisition cost of the portfolio and accordingly are amortized over the life of the portfolio using the interest method. The balance of the unamortized capitalized fees at September 30, 2010 and 2009 was $3,105,239 and $3,262,929, respectively. During the three and nine months ended September 30, 2010, the Company capitalized $177,337 and $624,168, respectively, of these direct acquisition fees. During the three and nine months ended September 30, 2009, the Company capitalized $156,248 and $805,962, respectively, of these direct acquisition fees. During the three and nine months ended September 30, 2010, the Company amortized $233,603 and $750,855, respectively, of these direct acquisition fees. During the three and nine months ended September 30, 2009, the Company amortized $206,270 and $621,593, respectively, of these direct acquisition fees.

The agreements to purchase the aforementioned receivables include general representations and warranties from the sellers covering account holder death or bankruptcy and accounts settled or disputed prior to sale. The representation and warranty period permitting the return of these accounts from the Company to the seller is typically 90 to 180 days. Any funds received from the seller of finance receivables as a return of purchase price are referred to as buybacks. Buyback funds are applied against the finance receivable balance received and are not included in the Company s cash collections from operations. In some cases, the seller will replace the returned accounts with new accounts in lieu of returning the purchase price. In that case, the old account is removed from the pool and the new account is added.

Changes in finance receivables, net for the three and nine months ended September 30, 2010 and 2009 are as follows (amounts in thousands):

| | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2010 | Nine Months Ended September 30, 2009 |
|---|---|---|---|---|
| Balance at beginning of period | $ 775,606 | $ 624,592 | $ 693,462 | $ 563,830 |
| Acquisitions of finance receivables, net of buybacks | 88,984 | 74,318 | 273,858 | 210,116 |

| | | | | |
|---|---|---|---|---|
| Cash collections | (137,377) | (92,367) | (384,978) | (272,717) |
| Income recognized on finance receivables, net | 80,026 | 54,336 | 224,897 | 159,650 |
| Cash collections applied to principal | (57,351) | (38,031) | (160,081) | (113,067) |
| Balance at end of period | $ 807,239 | $ 660,879 | $ 807,239 | $ 660,879 |

At the time of acquisition, the life of each pool is generally estimated to be between 84 to 96 months based on projected amounts and timing of future cash collections using the proprietary models of the Company. As of

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

September 30, 2010, the Company had $807.2 million in finance receivables, net. Based upon projections as of September 30, 2010, cash collections applied to principal are estimated to be as follows for the twelve months in the periods ending (amounts in thousands):

| | |
|---|---|
| September 30, 2011 | $ 188,821 |
| September 30, 2012 | 207,400 |
| September 30, 2013 | 208,665 |
| September 30, 2014 | 150,098 |
| September 30, 2015 | 45,993 |
| September 30, 2016 | 5,816 |
| September 30, 2017 | 446 |
| | $ 807,239 |

During the three and nine months ended September 30, 2010, the Company purchased approximately $1.38 billion and $4.94 billion, respectively, in face value of charged-off consumer receivables. During the three and nine months ended September 30, 2009, the Company purchased approximately $1.75 billion and $6.09 billion, respectively, in face value of charged-off consumer receivables. At September 30, 2010, the estimated remaining collections ( ERC ) on the receivables purchased in the three and nine months ended September 30, 2010 were $171.6 million and $537.1 million, respectively. At September 30, 2010, ERC on the receivables purchased in the three and nine months ended September 30, 2009 were $137.7 million and $375.1 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 September 30, 2010 and 2009. 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 and nine months ended September 30, 2010 and 2009 were as follows (amounts in thousands):

| | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2010 | Nine Months Ended September 30, 2009 |
|---|---|---|---|---|
| Balance at beginning of period | $ 835,903 | $ 613,392 | $ 721,984 | $ 551,735 |
| Income recognized on finance receivables, net | (80,026) | (54,336) | (224,897) | (159,650) |
| Additions | 84,860 | 106,359 | 312,735 | 303,195 |
| Reclassifications (to)/from nonaccretable difference | 21,598 | 5,618 | 52,513 | (24,247) |
| Balance at end of period | $ 862,335 | $ 671,033 | $ 862,335 | $ 671,033 |

The Company maintains a valuation allowance on pools that had underperformed the Company s most recent expectations during the three and nine months ended September 30, 2010 and 2009. The following is a summary of activity, including allowance charges recorded, within the Company s valuation allowance account (amounts in thousands):

| | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2010 | Nine Months Ended September 30, 2009 |
|---|---|---|---|---|
| Balance at beginning of period | $ 64,445 | $ 33,760 | $ 51,255 | $ 23,620 |
| Allowance charges recorded | 7,375 | 8,395 | 20,675 | 19,305 |
| Reversal of previously recorded allowance charges | (855) | (385) | (965) | (1,155) |
| Change in allowance charge | 6,520 | 8,010 | 19,710 | 18,150 |
| Balance at end of period | $ 70,965 | $ 41,770 | $ 70,965 | $ 41,770 |

Table of Contents

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

**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 September 30, 2010 and December 31, 2009 was $3.0 million and $2.9 million, respectively. The Company does not have any off balance sheet credit exposure related to its customers.

**4. Line of Credit:**

On November 29, 2005, the Company entered into a Loan and Security Agreement for a revolving line of credit. The agreement has been amended six times to add additional lenders and ultimately increase the total availability of credit under the line to $365 million. The agreement is a line of credit in an amount equal to the lesser of $365 million or 30% of the Company s ERC of all its eligible asset pools. Borrowings under the revolving credit facility bear interest at a floating rate equal to the one month LIBOR Market Index Rate plus 1.40%, which equated to 1.66% at September 30, 2010. Of the $365 million facility, $50 million was locked in as an interest only term loan at a rate of 6.80% and expires on May 4, 2012. The remaining $315 million expires on May 2, 2011. The Company also pays an unused line fee equal to three-tenths of one percent, or 30 basis points, on any unused portion of the line of credit. The loan is collateralized by substantially all the tangible and intangible assets of the Company. The agreement provides as follows:

- monthly borrowings may not exceed 30% of ERC;
- funded debt to EBITDA (defined as net income, less income or plus loss from discontinued operations and extraordinary items, plus income taxes, plus interest expense, plus depreciation, depletion, amortization (including finance receivable amortization) and other non-cash charges) ratio must be less than 2.0 to 1.0 calculated on a rolling twelve-month average;
- tangible net worth must be at least 100% of tangible net worth reported at September 30, 2005, plus 25% of cumulative positive net income since the end of such fiscal quarter, plus 100% of the net proceeds from any equity offering without giving effect to reductions in tangible net worth due to repurchases of up to $100,000,000 of the Company s common stock; and
- restrictions on change of control.

As of September 30, 2010 and 2009, outstanding borrowings under the facility totaled $288.5 million and $306.3 million, respectively, of which $50.0 million was part of the non-revolving fixed rate sub-limit. As of September 30, 2010, the Company is in compliance with all of the covenants of the agreement.

**5. Derivative Instrument**:

The Company may periodically enter into derivative financial instruments, typically interest rate swap agreements, to reduce its exposure to fluctuations in interest rates on variable-rate debt and their impact on earnings and cash flows. The Company does not utilize derivative financial instruments with a level of complexity or with a risk greater than the exposure to be managed nor does it enter into or hold derivatives for trading or speculative purposes. The Company periodically reviews the creditworthiness of the swap counterparty to assess the counterparty s ability to honor its obligation. Counterparty default would expose the Company to fluctuations in variable interest rates. Based on the guidance of FASB ASC Topic 815 Derivatives and Hedging ( ASC 815 ), the Company records derivative financial instruments at fair value on the consolidated balance sheet.

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

On December 16, 2008, the Company entered into an interest rate forward rate swap transaction (the Swap ) with J.P. Morgan Chase Bank, National Association pursuant to an ISDA Master Agreement which contains customary representations, warranties and covenants. The Swap has an effective date of January 1, 2010, with a notional amount of $50.0 million. Under the Swap, the Company receives a floating interest rate based on one- month LIBOR Market Index Rate and pays a fixed interest rate of 1.89% through maturity of the Swap on May 1, 2011. Notwithstanding the terms of the Swap, the Company is ultimately obligated for all amounts due and payable under the credit facility.

The Company s financial derivative instrument is designated and qualifies as a cash flow hedge, and the effective portion of the gain or loss on such hedge is reported as a component of other comprehensive income/(loss) in the consolidated financial statements of the Company. To the extent that the hedging relationship is not effective, the ineffective portion of the change in fair value of the derivative is recorded in other income (expense). The hedge was considered effective for the twelve months ended December 31, 2009 and for the nine months ended September 30, 2010. Therefore, no amount has been recorded in the consolidated income statements related to the hedge s ineffectiveness during 2009 or the nine months ended September 30, 2010. Hedges that receive designated hedge accounting treatment are evaluated for effectiveness at the time that they are designated, as well as throughout the hedging period.

The following table sets forth the fair value amounts of the derivative instrument held by the Company as of the dates indicated (amounts in thousands):

| | **September 30, 2010** | | **December 31, 2009** | |
|---|---|---|---|---|
| Derivative designated as hedging instruments under ASC 815: | Asset Derivative | Liability Derivative | Asset Derivative | Liability Derivative |
| Interest rate swap contract | $ | $ 537 | $ | $ 701 |
| Total derivative | $ | $ 537 | $ | $ 701 |

Liability derivatives are recorded in the liability section of the accompanying consolidated balance sheets.

The following table sets forth the (loss) recorded in Accumulated Other Comprehensive Loss ( AOCL ), net of tax, for the three and nine months ended September 30, 2010 and 2009, for derivatives held by the Company as well as any loss reclassified from AOCL into expense (amounts in thousands):

| | Amount of Loss Recognized in Accumulated Other Comprehensive Loss (Effective Portion) | | Location of Loss Reclassified from AOCL into Expense (Effective Portion) | Amount of Loss Reclassified from Accumulated Other Comprehensive Loss into Expense (Effective Portion) | |
|---|---|---|---|---|---|
| | Three Months Ended | | | Three Months Ended | |
| Derivative designated as hedging | September 30, | | | September 30, | |
| instruments under ASC 815: | 2010 | 2009 | | 2010 | 2009 |
| Interest rate swap contract | $ (62) | $ (214) | | $ (204) | $ |

| | | | | | |
|---|---|---|---|---|---|
| | | | Interest Expense | | |
| Total derivative | $ (62) | $ (214) | | $ (204) | $ |

| Derivative designated as hedging instruments under ASC 815: | Amount of Loss Recognized in Accumulated Other Comprehensive Loss (Effective Portion) Nine Months Ended September 30, | | Location of Loss Reclassified from AOCL into Expense (Effective Portion) | Amount of Loss Reclassified from Accumulated Other Comprehensive Loss into Expense (Effective Portion) Nine Months Ended September 30, | |
|---|---|---|---|---|---|
| | 2010 | 2009 | | 2010 | 2009 |
| Interest rate swap contract | $ (273) | $ (435) | Interest Expense | $ (611) | $ |
| Total derivative | $ (273) | $ (435) | | $ (611) | $ |

12

Table of Contents

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

Amounts in accumulated other comprehensive loss will be reclassified into earnings under certain situations, for example, if the occurrence of the transaction is no longer probable or no longer qualifies for hedge accounting. The Company expects to reclassify approximately $537,000 currently included in accumulated other comprehensive loss, net of taxes into interest expense within the next 12 months.

**6. 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 $2,036,114. The loan, which matures on February 28, 2012, is collateralized by the related computer software and equipment, has a three year loan term with a fixed rate of 4.78% and provides for monthly installment payments, including interest, of $60,823 beginning on March 31, 2009.

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

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

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Software | $ 19,675 | $ 16,542 |
| Computer equipment | 10,162 | 8,869 |
| Furniture and fixtures | 5,970 | 5,624 |
| Equipment | 7,310 | 6,040 |
| Leasehold improvements | 3,429 | 3,277 |
| Building and improvements | 6,045 | 6,045 |
| Land | 992 | 992 |
| Accumulated depreciation and amortization | (30,789) | (25,525) |
| Property and equipment, net | $ 22,794 | $ 21,864 |

Depreciation and amortization expense, relating to property and equipment, for the three and nine months ended September 30, 2010, was $1,814,249 and $5,314,419, respectively. Depreciation and amortization expense, relating to property and equipment, for the three and nine months ended September 30, 2009, was $1,600,764 and $4,869,540, 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 September 30, 2010, the Company has incurred and capitalized $3,934,892 of these direct payroll costs and external direct costs related to software developed for internal use. Of these costs, $1,169,007 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 and nine months ended September 30, 2010 was $134,654 and $297,483, respectively. Amortization expense for the three and nine months ended September 30, 2009 was $25,229 and $69,501, respectively. The remaining unamortized costs relating to internally developed software at September 30, 2010 and 2009 were $2,229,784 and $523,079, respectively.

Table of Contents

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

**8. Business Acquisitions:**

On March 15, 2010, the Company acquired 62% of the membership units of CCB. The remaining 38% of the membership units were acquired by Claims Compensation Bureau, Inc., CCB s predecessor. Claims Compensation Bureau, Inc. was founded in 1996 and is a leading provider of class action claims settlement recovery services and related payment processing to corporate clients. CCB s process allows clients to maximize settlement recoveries, in many cases participating in settlements they would otherwise not know existed. The company charges fees for its services and works with clients to identify, prepare and submit claims to class action administrators charged with dispersing class action settlement funds. In connection with the acquisition, the president and founder of CCB, as well as another member of its senior management, entered into long-term employment agreements with the Company. The consolidated income statement for the nine months ended September 30, 2010 includes the results of operations of CCB from March 15, 2010 through September 30, 2010.

The Company s initial investment for the 62% ownership of CCB was paid for with $23.0 million in cash plus $2.0 million in deferred payments which are expected to be paid during 2010 if certain events occur. Of the $2.0 million, $1.0 million was paid in the second quarter of 2010 and the remaining $1.0 million is expected to be paid by December 31, 2010. The remaining deferred payment is included in the accrued expenses and other liabilities account on the consolidated balance sheet as of September 30, 2010. As part of the agreement, the Company has the right through February 28, 2015 to purchase the remaining 38% of CCB at certain multiples of EBITDA. In addition, beginning March 1, 2012 and ending February 28, 2018, the noncontrolling interest can require the Company to purchase its units at pre-defined multiples of EBITDA. Any future acquisitions by the Company of the noncontrolling interest will be accounted for as an equity transaction.

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, any noncontrolling interest in the acquiree, and the consideration given at their fair value on the acquisition date. The following tables summarize the fair value of the consideration given for CCB, as well as the fair value of the assets acquired, liabilities assumed, and the noncontrolling interest in the acquiree as of the March 15, 2010 acquisition date (amounts in thousands):

| | |
|---|---|
| Purchase price consideration given: | |
| Cash | $ 23,000 |
| Contingent consideration arrangement | 2,000 |
| Fair value of total consideration given | $ 25,000 |

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

| | |
|---|---|
| Contractual relationships | $ 12,000 |
| Tradenames | 400 |
| Non-compete agreements | 500 |
| Cash | 500 |
| Software | 67 |
| Other assets | 2 |
| Total identifiable net assets acquired | 13,469 |
| Goodwill | 26,854 |
| Estimated fair value of acquired business | 40,323 |
| Redeemable noncontrolling interest in CCB | 15,323 |

| | |
|---|---|
| Purchase price consideration given | $ 25,000 |

14

Table of Contents

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

The estimated fair value of the noncontrolling interest in CCB was determined as the percentage of the noncontrolling interest multiplied by the fair value of all assets which were derived from the acquisition of CCB on March 15, 2010.

On June 11, 2010, the Company s wholly-owned subsidiary, RDS, acquired substantially all the assets of Tax Return, Inc. for $500,000. The purchase price was allocated to a non-competition agreement, fixed assets and goodwill, all of which are included as assets of RDS. There is no contingent consideration associated with this acquisition.

The acquisition of CCB levers the Company s competency in payment and administrative processing, while broadening its scope of services. The acquisition of Tax Return, Inc. further expands the audit expertise and capacity of the Company s government services business.

**9. Redeemable Noncontrolling Interest:**

In accordance with ASC 810, the Company has consolidated all financial statement accounts of CCB in its consolidated balance sheet as of September 30, 2010 and its consolidated income statements for the three and nine months ended September 30, 2010. The redeemable noncontrolling interest amount is separately stated on the consolidated balance sheet and represents the 38% interest in CCB not controlled by the Company. In addition, net income attributable to the noncontrolling interest is stated separately in the consolidated income statements for the three and nine months ended September 30, 2010.

In the second quarter of 2010, the Company applied 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. 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. 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. The Company has recorded the redeemable noncontrolling interest amount outside of permanent equity, in accordance with ASC 480-10-S99. 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 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 $22,800,000 as of September 30, 2010.

The following table represents the changes in the redeemable noncontrolling interest for the period from March 15, 2010 to September 30, 2010 (amounts in thousands):

| | |
|---|---|
| Acquisition date fair value of redeemable noncontrolling interest | $ 15,323 |
| Net income attributable to redeemable noncontrolling interest | 431 |
| Distributions | (1,223) |
| Redeemable noncontrolling interest at September 30, 2010 | $ 14,531 |

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

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

In connection with the Company s business acquisitions, the Company purchased certain tangible and intangible assets. Intangible assets purchased included client and customer relationships, non-compete agreements, trademarks and goodwill. In accordance FASB ASC Topic 350 Intangibles-Goodwill and Other ( ASC 350 ), the Company is amortizing the following intangible assets over the estimated useful lives as indicated:

| | Acquisition Date | Customer Relationships | Non-Compete Agreements | Trademarks |
|---|---|---|---|---|
| IGS | October 1, 2004 | 7 years | 3 years (1) | |
| RDS (2) | July 29, 2005 | 10 years | 3 years (1) | |
| The Palmer Group (2) | July 25, 2007 | 2.4 years (1) | | |
| MuniServices (2) | July 1, 2008 | 11 years | 3 years | 14 years |
| BPA (2) | August 1, 2008 | 10 years | 2.4 years | |
| CCB | March 15, 2010 | 4-7 years | 3 years | 14 years |
| Tax Return, Inc. (2) | June 11, 2010 | | 3.5 years | |

(1) These intangible assets are fully amortized with no expense recognized during 2010.

(2) Operates as part of the Company s government services group.

The combined original weighted average amortization period is 8.1 years. The Company reviews these assets at least annually for impairment. Total amortization expense was $1,479,702 and $3,735,977 for the three and nine months ended September 30, 2010, respectively. Total amortization expense was $668,277 and $2,004,831 for the three and nine months ended September 30, 2009, respectively. In addition, goodwill, pursuant to ASC 350, is not amortized but rather is reviewed at least annually for impairment. During the fourth quarter of 2009, the Company underwent its annual review of goodwill. Based upon the results of this review, which was conducted as of October 1, 2009, 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 September 30, 2010 that would indicate a triggering event and thereby necessitate an impairment charge to goodwill or the other intangible assets. The Company will undergo its next annual goodwill review during the fourth quarter of 2010. At September 30, 2010 and December 31, 2009, the carrying value of goodwill was $61.7 million and $29.3 million, respectively. The $32.4 million increase in the carrying value of goodwill during the nine months ended September 30, 2010 mainly relates to the purchase of CCB on March 15, 2010 (see Note 8) and additional contingent purchase price of $5.0 million paid in stock relating to the achievement of the earn-out provisions of the MuniServices acquisition.

**11. Share-Based Compensation:**

The Company has a stock option and nonvested share plan. The Company created the 2002 Stock Option Plan (the Plan ) on November 7, 2002. The Plan was amended in 2004 (the Amended Plan ) to enable the Company to issue nonvested shares of stock to its employees and directors. The Amended Plan was approved by the Company s shareholders at its Annual Meeting on May 12, 2004. On March 19, 2010, the Company adopted a 2010 Stock Plan, which was approved by its shareholders at the 2010 Annual Meeting. The 2010 Stock Plan is a further amendment to the Amended Plan, and contains, among other things, specific performance metrics with respect to performance-based stock awards. Up to 2,000,000 shares of common stock may be issued under the 2010 Stock Plan. The 2010 Stock Plan expires November 7, 2012.

The Company follows the provisions of FASB ASC Topic 718 Compensation-Stock Compensation ( ASC 718 ). As of September 30, 2010, 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 $3.3 million with a weighted average remaining life of 2.3 years (not including nonvested shares granted under the LTI Programs). As of September 30, 2010, there are no future compensation costs related to stock options and the remaining vested stock options have a weighted average remaining life of 0.30 years. 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

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

the employee grants. Grants made to key employee hires 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 $1,040,124 and $3,114,010 for the three and nine months ended September 30, 2010, respectively. Total share-based compensation expense was $588,595 and $3,240,301 for the three and nine months ended September 30, 2009, respectively. The Company, in conjunction with the renewal of employment agreements with its named executive officers and other senior executives, awarded nonvested shares which vested on January 1, 2009. As a result of the vesting of these shares, the Company recorded stock-based compensation expense in connection with these shares in the amount of approximately $1.4 million during the first quarter of 2009. Tax benefits resulting from tax deductions in excess of share-based compensation expense recognized under the fair value recognition 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 $309,529 and $777,115 for the three and nine months ended September 30, 2010, respectively. The total tax benefit realized from share-based compensation was $731,867 and $1,923,946 for the three and nine months ended September 30, 2009, respectively.

***Stock Options***

All options issued under the Amended Plan vest ratably over five years. Granted options expire seven years from the applicable grant date. All outstanding stock options expire on January 16, 2011. Options granted to a single person cannot exceed 200,000 in a single year. At September 30, 2010, 895,000 options have been granted under the Amended Plan, of which 118,955 have been cancelled. There were no antidilutive options outstanding for the three and nine months ended September 30, 2010 and 2009, respectively.

The Company granted no options during the three and nine months ended September 30, 2010 and 2009. All of the stock options which have been granted under the Amended Plan were granted to employees of the Company, except for 40,000 which were granted to non-employee directors. The total intrinsic value of options exercised during the three and nine months ended September 30, 2010 was approximately $0 and $77,000, respectively. The total intrinsic value of options exercised during the three and nine months ended September 30, 2009 was approximately $1,199,000 and $2,306,000, respectively.

The following summarizes all option related transactions from December 31, 2008 through September 30, 2010 (amounts in thousands, except per share amounts):

| | Options Outstanding | Weighted-Average Exercise Price Per Share | Weighted-Average Fair Value Per Share |
|---|---|---|---|
| December 31, 2008 | 123 | $ 17.24 | $ 3.21 |
| Exercised | (116) | 16.51 | 3.24 |
| December 31, 2009 | 7 | 29.41 | 2.70 |
| Exercised | (2) | 28.45 | 2.92 |
| September 30, 2010 | 5 | $ 29.79 | $ 2.62 |

The following information is as of September 30, 2010 (amounts in thousands, except per share amounts):

| Options Outstanding | Options Exercisable |
|---|---|

| Exercise Price | Number Outstanding | Average Remaining Contractual Life | Weighted-Average Exercise Price Per Share | Aggregate Intrinsic Value | Number Exercisable | Weighted-Average Exercise Price Per Share | Aggregate Intrinsic Value |
|---|---|---|---|---|---|---|---|
| $29.79 | 5 | 0.3 | $ 29.79 | $ 174 | 5 | $ 29.79 | $ 174 |
| Total as of September 30, 2010 | 5 | 0.3 | $ 29.79 | $ 174 | 5 | $ 29.79 | $ 174 |

Table of Contents

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

The Company utilizes the Black-Scholes option pricing model to calculate the value of the stock options when granted. This model was developed to estimate the fair value of traded options, which have different characteristics than employee stock options. In addition, changes to the subjective input assumptions can result in materially different fair market value estimates. Therefore, the Black-Scholes model may not necessarily provide a reliable single measure of the fair value of employee stock options.

***Nonvested Shares***

With the exception of the awards made pursuant to the LTI Program and a few employee and director grants, the terms of the nonvested share awards are similar to those of the stock option awards, wherein the nonvested shares vest ratably over five years and are expensed over their vesting period.

The following summarizes all nonvested share transactions (excluding shares granted under the LTI Programs) from December 31, 2008 through September 30, 2010 (amounts in thousands, except per share amounts):

| | Nonvested Shares Outstanding | Weighted-Average Price at Grant Date |
|---|---|---|
| December 31, 2008 | 98 | $ 41.60 |
| Granted | 70 | 34.22 |
| Vested | (82) | 36.62 |
| Cancelled | (5) | 42.20 |
| December 31, 2009 | 81 | 40.24 |
| Granted | 52 | 51.64 |
| Vested | (34) | 41.52 |
| Cancelled | (5) | 39.66 |
| September 30, 2010 | 94 | $ 46.15 |

The total grant date fair value of shares vested during the three and nine months ended September 30, 2010 was $497,077 and $1,387,399, respectively. The total grant date fair value of shares vested during the three and nine months ended September 30, 2009 was $464,690 and $2,094,180, respectively.

***Long-Term Incentive Programs***

Pursuant to the Amended Plan, on March 30, 2007, January 4, 2008, January 20, 2009 and January 14, 2010, the Compensation Committee approved the grant of 96,550, 80,000, 108,720 and 53,656 performance-based nonvested shares, respectively. All shares granted under the LTI Programs were granted to key employees of the Company. For both the 2007 and 2008 grants, no estimated compensation costs have been accrued or recognized because the achievements of the performance targets of the programs were either not met or deemed unlikely to be achieved. The 2009 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 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 shareholder return as compared to a peer group for the same three year period. 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, 2009. 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 EPS component of the 2009 plan was not achieved and therefore no compensation expense was recognized during 2009 or the three and nine

months ended September 30, 2010. 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



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

ending December 31, 2012, and the relative total shareholder return as compared to a peer group for the same three year period. 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, 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. At September 30, 2010, total future compensation costs related to nonvested share awards granted under the 2009 and 2010 LTI Programs are estimated to be approximately $3.5 million. The Company assumed a 7.5% forfeiture rate for this grant and the remaining shares have a weighted average life of 1.67 years at September 30, 2010.

**12. 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 September 30, 2010 and 2009.

The Company was notified on June 21, 2007 that it was being examined by the Internal Revenue Service for the 2005 calendar year. The IRS has concluded its audit and on March 19, 2009 issued Form 4549-A, Income Tax Examination Changes for tax years ending December 31, 2007, 2006 and 2005. The IRS has proposed 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, the Company filed a formal protest of the findings contained in the examination report prepared by the IRS. 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. If the Company is unsuccessful in its appeal, it might ultimately be required to pay the related deferred taxes and any potential interest, possibly requiring additional financing from other sources.

At September 30, 2010, the tax years subject to examination by the major taxing jurisdictions, including the Internal Revenue Service, are 2003 and 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 period for the 2005, 2006 and 2007 tax years were extended through December 31, 2011.

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. Penalties and interest may be classified as either penalties and interest expense or income tax expense. Management has elected to classify accrued penalties and interest as income tax expense. No interest or penalties were accrued or reversed in the first three or nine months of 2009 or 2010.

**13. Earnings per Share:**

Basic EPS are computed by dividing net income available to common shareholders 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 following tables provide a reconciliation between the computation of basic EPS and diluted EPS for the three and nine months ended September 30, 2010 and 2009 (amounts in thousands, except per share amounts):

Table of Contents

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

| | **For the three months ended September 30,** | | | | | |
|---|---|---|---|---|---|---|
| | | **2010** | | | **2009** | |
| | 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 | $ 18,481 | 17,058 | $ 1.08 | $ 10,096 | 15,466 | $ 0.65 |
| Dilutive effect of stock options and nonvested share awards | | 35 | | | 36 | |
| Diluted EPS | $ 18,481 | 17,093 | $ 1.08 | $ 10,096 | 15,502 | $ 0.65 |

| | **For the nine months ended September 30,** | | | | | |
|---|---|---|---|---|---|---|
| | | **2010** | | | **2009** | |
| | 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 | $ 52,811 | 16,740 | $ 3.15 | $ 31,892 | 15,392 | $ 2.07 |
| Dilutive effect of stock options and nonvested share awards | | 52 | | | 36 | |
| Diluted EPS | $ 52,811 | 16,792 | $ 3.15 | $ 31,892 | 15,428 | $ 2.07 |

There were no antidilutive options outstanding for the three and nine months ended September 30, 2010 and 2009.

**14. Commitments and Contingencies:**

*Employment Agreements:*

The Company has employment agreements, most of which expire on December 31, 2011, 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 $10.2 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, 2009.

*Forward Flow Agreements:*

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 September 30, 2010 is approximately $104.8 million.

*Business Acquisition:*

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 five years. Also, Claims Compensation Bureau, Inc., the holder of such remaining 38% interest in CCB can require the Company to purchase its 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 such 38% interest is $22.8 million. In addition, the Company expects to pay the remaining $1.0 million deferred portion of the acquisition date consideration for its 62% interest in CCB by December 31, 2010, upon the expected occurrence of certain events.

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

*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 consumers and is occasionally countersued by them in such actions. Also, consumers, either individually, as members of a class action, or through a governmental entity on behalf of consumers, 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 maintains appropriate levels of errors and omissions insurance coverage to protect against financial losses associated with potential litigation involving the Company, and while it is not expected that these or any other legal proceedings or claims in which the Company is involved will, either individually or in the aggregate, have a material adverse impact on the results of operations, liquidity or the Company s financial condition, the matters described below fall outside of the normal parameters of the Company s routine legal proceedings.

PRA is currently a defendant in a purported class action counterclaim entitled PRA v. Barkwell, 4:09-cv-00113-CDL, which was filed in response to a motion filed by PRA that sought to confirm an arbitration award, in the amount of $9,781.43. The counterclaim, which was filed against PRA, the National Arbitration Forum ( NAF ) and MBNA America Bank, N.A., on July 29, 2009 in the Superior Court of Muscogee County, Georgia, and has since been removed to the United States District Court for the Middle District of Georgia, where it is currently pending. The counterclaim alleges that in pursuing arbitration claims against Barkwell and other consumer debtors, pursuant to the terms and conditions of their respective cardholder agreements, PRA breached a duty of good faith and fair dealing and made negligent misrepresentations concerning its arbitration practices. The counterclaim asserts that because NAF was financially tied to Axiant, LLC, a large, nationwide debt collector, NAF lacked the necessary independence and impartiality to conduct arbitration proceedings, such as the ones filed by PRA, including the arbitration claim that was filed against Mr. Barkwell. Barkwell asserts that PRA knew, or should have known, of the relationship between NAF and Axiant, and brought this action on behalf of a purported class of consumers to, among other things, vacate the arbitration awards that PRA has obtained before NAF and have PRA disgorge the amounts collected with respect to such awards. While it is not possible at this time to accurately estimate the possible loss, if any, as the Company believes it has meritorious defenses to the allegations made in this counterclaim and intends to defend itself vigorously against them. This matter has not progressed to the discovery stage yet, therefore the Company currently lacks the necessary information to determine the aggregate amount of arbitration claims potentially impacted by the purported class herein.

As previously disclosed, PRA is also defendant in another purported class action related to matters previously brought before NAF, styled PRA v. Freeman (Case No.: 10-CVD-1003) which was filed in the District Court for Wake County, North Carolina on or about March 26, 2010. The court in PRA v. Freeman recently heard arguments on the motion to dismiss that PRA had filed earlier this year and has informed the parties that the matter will be dismissed, pending submission of an appropriate order. PRA anticipates submitting such an order and having the matter dismissed imminently.

The Company was also a defendant in a purported enforcement action brought by the Attorney General for the State of Missouri. The action, filed in August 2009, sought relief for Missouri consumers that had allegedly been injured as a result of certain of the Company s alleged collection practices. The Company denied any wrongdoing with respect to the allegations in the complaint and on June 25, 2010, the Missouri Circuit Court dismissed the matter in its entirety. On July 26, 2010, the Missouri Attorney General filed a notice of appeal.

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

*(a) Disclosures about Fair Value of Financial Instruments:*

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

21

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

Company. The carrying amounts in the table are recorded in the consolidated balance sheet under the indicated captions (amounts in thousands):

| | September 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets: | | | | |
| Cash and cash equivalents | $ 20,297 | $ 20,297 | $ 20,265 | $ 20,265 |
| Finance receivables, net | 807,239 | 1,067,140 | 693,462 | 839,417 |
| Financial liabilities: | | | | |
| Line of credit | $ 288,500 | $ 288,500 | $ 319,300 | $ 319,300 |
| Long-tern debt | 998 | 998 | 1,499 | 1,499 |
| Derivative instrument | 537 | 537 | 701 | 701 |

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.

**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.

**Line of credit:** 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.

**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.

**Derivative instrument:** The interest rate swap is recorded at estimated fair value, which is determined using pricing models developed based on the LIBOR swap rate and other observable market data, adjusted for non-performance risk of both the counterparty and the Company.

*(b) Fair Value Hierarchy:*

The Company records its derivative instrument at estimated fair value on a recurring basis. The accompanying consolidated financial statements include estimated fair value information regarding its derivative instrument as of September 30, 2010 and December 31, 2009, as required by FASB ASC Topic 820, Fair Value Measurements and Disclosures ( ASC 820 ). ASC 820 defines fair value as 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 quote 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.

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

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

methodologies, or similar techniques as well as instruments for which the determination of fair value requires significant management judgment or estimation.

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.

The placement in the fair value hierarchy of the Company s interest rate swap derivative instrument as of September 30, 2010 and December 31, 2009 is Level 2 based on the Level 2 inputs described in section (a) above. Refer to Note 5 for further information regarding the derivative instrument.

**16. Recent Accounting Pronouncements:**

In June 2009, the FASB issued guidance on accounting for transfers of financial assets to improve the reporting for the transfer of financial assets. The guidance must be applied as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company adopted the guidance during the first quarter of 2010, which had no material impact on its consolidated financial statements.

In June 2009, the FASB issued guidance on consolidation of variable interest entities to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. The guidance is effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company adopted the guidance during the first quarter of 2010, which had no material impact on its consolidated financial statements.

In January 2010, the FASB issued Accounting Standards Update ( ASU ) No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements ( ASU 2010-06 ), which clarifies and expands disclosure requirements related to fair value measurements. Disclosures are required for significant transfers between levels in the fair value hierarchy. Activity in Level 3 fair value measurements is to be presented on a gross, rather than net, basis. The update clarifies how the appropriate level of disaggregation should be determined and emphasizes that information sufficient to permit reconciliation between fair value measurements and line items on the financial statements should be provided. The update is effective for interim and annual reporting periods beginning after December 15, 2009, except for the expanded disclosures related to activity in Level 3 fair value measurements, which are effective one year later. The Company adopted ASU 2010-06 during the first quarter of 2010, which had no material effect on its consolidated financial statements.

In April 2010, the FASB issued ASU No. 2010-18, Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool that is Accounted for as a Single Asset ( ASU 2010-18 ), which clarifies the accounting for acquired loans that have evidence of a deterioration in credit quality since origination (referred to as Subtopic 310-30 Loans ). Under ASU 2010-18, an entity may not apply troubled debt restructuring ( TDR ) accounting guidance to individual Subtopic 310-30 loans that are part of a pool, even if the modification of those loans would otherwise be considered a troubled debt restructuring. Once a pool is established, individual loans should not be removed from the pool unless the entity sells, forecloses, or writes off the loan. Entities would continue to consider whether the pool of loans is impaired if expected cash flows for the pool change. Subtopic 310-30 loans that are accounted for individually would continue to be subject to TDR accounting guidance. A one-time election to terminate accounting for loans as a pool, which may be made on a pool-by-pool basis, is provided upon adoption of ASU 2010-18. ASU 2010-18 is effective for interim or annual periods ending on or after July 15, 2010. The Company adopted ASU 2010-18 during the third quarter of 2010, which had no material effect on its consolidated financial statements.

In July, 2010, the FASB issued ASU No. 2010-20, Receivables (Topic 310) Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses ( ASU 2010-20 ), which requires

Table of Contents

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

significant new disclosures about the allowance for credit losses and the credit quality of financing receivables. The requirements are intended to enhance transparency regarding credit losses and the credit quality of loan and lease receivables. Under this statement, allowance for credit losses and fair value are to be disclosed by portfolio segment, while credit quality information, impaired financing receivables and nonaccrual status are to be presented by class of financing receivable. Disclosure of the nature and extent, the financial impact and segment information of troubled debt restructurings will also be required. The disclosures are to be presented at the level of disaggregation that management uses when assessing and monitoring the portfolio s risk and performance. ASU 2010-20 is effective for interim and annual reporting periods ending on or after December 15, 2010. The adoption of ASU 2010-20 by the Company is not expected to have a material effect 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:

- changes in the economic or inflationary environment which have an adverse effect on the ability of consumers to pay their debts or on the stability of the financial system as a whole;
- our ability to purchase defaulted consumer receivables at appropriate prices;
- changes in the business practices of credit originators in terms of selling defaulted consumer receivables or outsourcing defaulted consumer receivables to third-party contingent fee collection agencies;
- our ability to retain, renegotiate or replace our existing credit facility;
- risks relating to the performance of our computer and telecommunications systems and our ability to successfully anticipate, manage or adopt technological advances within our industry;
- changes in government regulations that affect our ability to collect sufficient amounts on our acquired or serviced receivables;
- changes in or interpretation of tax laws;
- deterioration in economic conditions in the United States that may have an adverse effect on our collections, results of operations, revenue and stock price;
- changes in bankruptcy or collection agency laws that could negatively affect our business;
- our ability to employ and retain qualified employees, especially collection and information technology personnel;
- 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 to purchase or service defaulted consumer receivables;
- the degree and nature of our competition;
- our ability to comply with the provisions of the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated thereunder;
- our ability to retain existing clients and obtain new clients for our fee-for-service businesses;

- 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 Securities and Exchange Commission (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 2009 Annual Report on Form 10-K, filed on February 16, 2010.

**Table of Contents**

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**

Portfolio Recovery Associates is a diversified financial and business services company. We are a leading company in the business of purchasing and collecting defaulted consumer receivables. Those finance receivables fall into two general categories: bankruptcy portfolios and charged-off core portfolios. Revenue for this part of our business consists of cash collections received less amounts applied to principal on the Company s owned debt portfolios.

Through our subsidiaries, we provide a broad range of fee-based business services. Those services include collateral location services to credit originators through our IGS subsidiary; revenue administration, discovery, and compliance services to governmental entities through both our RDS and MuniServices subsidiaries; and class action claims recovery services through our CCB subsidiary.

Portfolio Recovery Associates is headquartered in Norfolk, Virginia, and employs approximately 2,400 team members. The shares of Portfolio Recovery Associates are traded on the NASDAQ Global Select Market under the symbol PRAA.

On July 21, 2010 the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) became law. The Dodd-Frank Act restructures the regulation and supervision of the financial services industry. Many of the provisions of the Dodd-Frank Act have extended implementation periods and delayed effective dates and will require extensive rulemaking by regulatory authorities. The ultimate impact of the act cannot be determined.

*Earnings Summary*

During the third quarter of 2010, net income was $18.5 million, or $1.08 per diluted share, compared with $10.1 million, or $0.65 per diluted share, in the third quarter of 2009. Total revenue was $95.5 million in the third quarter of 2010, up 39.2% from the same quarter one year earlier. Revenue in the recently completed quarter consisted of $80.0 million in income recognized on finance receivables, net of allowance charges, and $15.5 million in fee income. Income recognized on finance receivables, net of allowance charges, increased $25.7 million, or 47.3%, over the same period in 2009, primarily as a result of a significant increase in cash collections. Cash collections were $137.4 million in the third quarter of 2010, up 48.7% over $92.4 million in the third quarter of 2009. During the quarter, the Company recorded $6.5 million in net allowance charges, compared with $8.0 million in the comparable quarter of 2009. The Company s performance has been positively impacted by operational efficiencies surrounding the cash collections process, including the continued refinement of automated dialer technology and account scoring analytics. Additionally, the Company has continued to develop its internal legal collection staff resources, which enables us to place accounts into that channel that otherwise would have been prohibitively expense for legal action.

Fee income increased from $14.2 million in the third quarter of 2009 to $15.5 million in the third quarter of 2010, as a result of the acquisition of a majority interest of CCB in March 2010. CCB provides class action claim processing services to businesses. Excluding the fee income attributable to CCB, fee income declined slightly over the third quarter of 2009, due primarily to the adverse impact of the economic slowdown on general business growth and governmental tax revenues.

Table of Contents

Operating expenses were $62.7 million in the third quarter of 2010, up 26% over the third quarter of 2009, due primarily to increased compensation expense and legal costs. Compensation expense increased primarily as a result of larger staff sizes. Legal and agency fees and costs increased from $11.3 million in the third quarter of 2009 to $16.7 million in the third quarter of 2010. This increase was the result of several factors, including growth in the size of our owned debt portfolios, expansion of our internal legal collection resources, and refinement of our internal scoring methodology that expanded our account selections for legal action.

**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, receivables 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:

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Revenues: | | | | |
| Income recognized on finance receivables, net | 83.8% | 79.2% | 82.7% | 76.8% |
| Fee income | 16.2% | 20.8% | 17.3% | 23.2% |
| Total revenues | 100.0% | 100.0% | 100.0% | 100.0% |
| Operating expenses: | | | | |
| Compensation and employee services | 32.7% | 39.2% | 33.7% | 38.5% |
| Legal and agency fees and costs | 17.5% | 16.5% | 16.0% | 16.6% |
| Outside fees and services | 3.6% | 3.3% | 3.5% | 3.3% |
| Communications | 4.2% | 5.1% | 4.8% | 5.4% |
| Rent and occupancy | 1.4% | 1.9% | 1.4% | 1.7% |
| Depreciation and amortization | 3.4% | 3.3% | 3.3% | 3.3% |
| Other operating expenses | 2.8% | 3.4% | 2.8% | 3.1% |
| Total operating expenses | 65.6% | 72.7% | 65.5% | 71.9% |
| Income from operations | 34.4% | 27.3% | 34.5% | 28.1% |
| Other income and (expense): | | | | |
| Interest income | 0.0% | 0.0% | 0.0% | 0.1% |
| Interest expense | (2.3%) | (2.9%) | (2.4%) | (2.8%) |
| Income before income taxes | 32.1% | 24.4% | 32.1% | 25.4% |
| Provision for income taxes | 12.4% | 9.8% | 12.4% | 10.0% |
| Net income | 19.7% | 14.6% | 19.7% | 15.4% |
| Less net income attributable to redeemable noncontrolling interest | (0.3%) | 0.0% | (0.2%) | 0.0% |

| | | | | |
|---|---|---|---|---|
| Net income attributable to Portfolio Recovery Associates, Inc. | 19.4% | 14.6% | 19.5% | 15.4% |

We use the following terminology throughout our reports: Cash Receipts refers to collections on our owned portfolios together with fee income. Cash Collections refers to collections on our owned portfolios only, exclusive of fee income. Fee Income refers to revenues generated from our contingent fee and fee-for-service subsidiaries.

27

Table of Contents

***Three Months Ended September 30, 2010 Compared To Three Months Ended September 30, 2009***

**Revenues**

Total revenues were $95.5 million for the three months ended September 30, 2010, an increase of $26.9 million or 39.2% compared to total revenues of $68.6 million for the three months ended September 30, 2009.

*Income Recognized on Finance Receivables, net*

Income recognized on finance receivables, net was $80.0 million for the three months ended September 30, 2010, an increase of $25.7 million or 47.3% compared to income recognized on finance receivables, net of $54.3 million for the three months ended September 30, 2009. The increase was primarily due to an increase in our cash collections on our owned defaulted consumer receivables to $137.4 million for the three months ended September 30, 2010 compared to $92.4 million for the three months ended September 30 2009, an increase of $45.0 million or 48.7%. During the three months ended September 30, 2010, we acquired defaulted consumer receivables portfolios with an aggregate face value amount of $1.38 billion at a cost of $92.5 million. During the three months ended September 30, 2009, we acquired defaulted consumer receivable portfolios with an aggregate face value of $1.75 billion at a cost of $76.7 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 estimated profitability of a period s buying.

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 September 30, 2010, we recorded net allowance charges of $6.5 million, the majority of which related to non-bankruptcy portfolios acquired in 2005 through 2007. For the three months ended September 30, 2009, we recorded net allowance charges of $8.0 million, the majority of which related to non-bankruptcy portfolios acquired in 2005 through 2008. 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: overall market pricing for pools of consumer receivables (which is driven by both supply and demand), 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 $15.5 million for the three months ended September 30, 2010, an increase of $1.3 million or 9.2% compared to fee income of $14.2 million for the three months ended September 30, 2009. Fee income increased primarily due to the revenue generated as a result the acquisition of CCB on March 15, 2010, offset by a decrease in revenue generated by our government services businesses and our IGS fee-for-service business as compared to the prior year period. Excluding the fee income attributable to CCB, fee income declined slightly over the third quarter of 2009, due primarily to the adverse impact of the economic slowdown on general business growth and governmental tax revenues.

**Operating Expenses**

Total operating expenses were $62.7 million for the three months ended September 30, 2010, an increase of $12.9 million or 25.9% compared to total operating expenses of $49.8 million for the three months ended September 30, 2009. Total operating expenses, including compensation and employee services expenses, were 41.0% of cash receipts for the three months ended September 30, 2010 compared to 46.7% for the same period in 2009.

*Compensation and Employee Services*

Compensation and employee services expenses were $31.2 million for the three months ended September 30, 2010, an increase of $4.4 million or 16.4% compared to compensation and employee services expenses of $26.8 million for the three months ended September 30, 2009. This increase is mainly due to an overall increase in our owned portfolio collection staff as well as the hiring of non-collection personnel mainly due to the expansion of our information technology department. Compensation and employee services expenses increased as total employees grew 12.8% to 2,421 as of September 30, 2010 from 2,146 as of September 30, 2009. Compensation and employee services expenses as a percentage of cash receipts decreased to 20.4% for the three months ended September 30, 2010 from 25.2% of cash receipts for the same period in 2009.

*Legal and Agency Fees and Costs*

Legal and agency fees and costs were $16.7 million for the three months ended September 30, 2010, an increase of $5.4 million or 47.8% compared to legal and agency fees and costs of $11.3 million for the three months ended September 30, 2009. Of the $5.4 million increase, $6.2 million was attributable to an increase in legal fees and costs resulting from accounts referred to both our in-house attorneys and outside independent contingent fee attorneys. This increase was largely due to the refinement of our internal scoring methodology that expanded our account selections for legal action. Growth in the size of our owned debt portfolios and expansion of our internal legal collection resources were also contributing factors. The increase in legal fees and costs was partially offset by a $0.8 million decline in agency fees. Total legal fees paid to independent contingent fee attorneys for the three months ended September 30, 2010 were 22.6% of external legal cash collections compared to 23.7% for the three months ended September 30, 2009. These legal fees represent the contingent fees for the cash collections generated by our independent third party attorney network. Total legal costs paid to bring suit on our legal accounts totaled $9.3 million for the three months ended September 30, 2010 and $4.1 million for the three months ended September 30, 2009. As a percentage of total legal collections, these legal costs were 28.8% and 19.1% for the three month periods ended September 30, 2010 and 2009, respectively.

*Outside Fees and Services*

Outside fees and services expenses were $3.5 million for the three months ended September 30, 2010, an increase of $1.2 million or 52.2% compared to outside fees and services expenses of $2.3 million for the three months ended September 30, 2009. The $1.2 million increase was attributable to an increase in other outside fees and services and corporate legal expense.

*Communications*

Communications expenses were $4.0 million for the three months ended September 30, 2010, an increase of $0.5 million or 14.3% compared to communications expenses of $3.5 million for the three months ended September 30, 2009. The increase was attributable to growth in mailings and higher telephone expenses driven by a greater number of defaulted consumer receivables to work. Mailings were responsible for 80.0% or $0.4 million of this increase, while the remaining 20.0% or $0.1 million was attributable to increased call volumes.

*Rent and Occupancy*

Rent and occupancy expenses were $1.4 million for the three months ended September 30, 2010, an increase of $0.1 million or 7.7% compared to rent and occupancy expenses of $1.3 million for the three months ended September 30, 2009. The increase was primarily due to relocation of our IGS business to another location, the expansion of our Hampton, Virginia call center, the acquisition of CCB and increased utility charges.

*Depreciation and Amortization*

Depreciation and amortization expenses were $3.3 million for the three months ended September 30, 2010, an increase of $1.0 million or 43.5% compared to depreciation and amortization expenses of $2.3 million for the three months ended September 30, 2009. The increase is mainly due to additional amortization expense incurred relating to the intangible assets of our newly acquired CCB subsidiary as well as continued capital expenditures on equipment, software, and computers related to our growth and systems upgrades.

*Other Operating Expenses*

Other operating expenses were $2.6 million for the three months ended September 30, 2010, an increase of $0.3 million or 13.0% compared to other operating expenses of $2.3 million for the three months ended September 30, 2009. The increase was mainly due to increases in various expenses when compared to the prior year period. No individual item represents a significant portion of the overall increase.

**Interest Income**

Interest income was $0 for both the three months ended September 30, 2010 and 2009.

**Interest Expense**

Interest expense was $2.2 million for the three months ended September 30, 2010, a increase of $0.2 million compared to interest expense of $2.0 million for the three months ended September 30, 2009. The increase was mainly due to an increase in our average borrowings under our revolving credit facility for the three months ended September 30, 2010 compared to the same period in 2009 as well as the interest expense paid during 2010 relating to the interest rate swap, offset by a decrease in our weighted average interest rate which decreased to 2.43% for the three months ended September 30, 2010, as compared to 2.56% for the three months ended September 30, 2009, including the effect of the interest rate swap derivative.

**Provision for Income Taxes**

Income tax expense was $11.9 million for the three months ended September 30, 2010, an increase of $5.2 million or 77.6% compared to income tax expense of $6.7 million for the three months ended September 30, 2009. The increase is mainly due to an increase of 82.1% in income before taxes for the three months ended September 30, 2010 as compared to the same period in 2009. This was offset by a decrease in the effective tax rate of 38.8% for the three months ended September 30, 2010, compared to an effective tax rate of 40.0% for the same period in 2009, primarily due to the impact of permanent items.

***Nine months Ended September 30, 2010 Compared To Nine months Ended September 30, 2009***

**Revenues**

Total revenues were $272.0 million for the nine months ended September 30, 2010, an increase of $64.1 million or 30.8% compared to total revenues of $207.9 million for the nine months ended September 30, 2009.

*Income Recognized on Finance Receivables, net*

Income recognized on finance receivables, net was $224.9 million for the nine months ended September 30, 2010, an increase of $65.2 million or 40.8% compared to income recognized on finance receivables, net of $159.7 million for the nine months ended September 30, 2009. The increase was primarily due to an increase in our cash collections on our owned defaulted consumer receivables to $385.0 million for the nine months ended September 30, 2010 compared to $272.7 million for the nine months September 30, 2009, an increase of $112.3 million or 41.2%. During the nine months ended September 30, 2010, we acquired defaulted consumer receivables portfolios with an aggregate face value amount of $4.94 billion at a cost of $281.9 million. During the nine months ended September 30, 2009, we acquired defaulted consumer receivable portfolios with an aggregate face value of $6.09 billion at a cost of $213.8 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 estimated profitability of a period s buying.

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 change in timing of cash flows which would otherwise require a reduction in the stated yield on a pool of accounts. For the nine months ended September 30, 2010, we recorded net allowance charges of $19.7 million, the majority of which related to non-bankruptcy portfolios acquired in 2005 through 2007. For the nine months ended September 30, 2009, we recorded net allowance charges of $18.2 million, the majority of which related to non-bankruptcy portfolios acquired in 2005 through 2008. 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: overall market pricing for pools of consumer receivables (which is driven by both supply and demand), 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, consequentially, 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 $47.1 million for the nine months ended September 30, 2010, a decrease of $1.1 million or 2.3% compared to fee income of $48.2 million for the nine months ended September 30, 2009. Fee income declined as a result of a decrease in revenue generated by our IGS fee-for-service business and our government services businesses due primarily to the adverse impact of the economic slowdown on general business growth and governmental tax revenues, partially offset by an increase in revenue generated as compared to the prior year period as a result of the acquisition of CCB on March 15, 2010.

**Operating Expenses**

Total operating expenses were $178.4 million for the nine months ended September 30, 2010, an increase of $29.0 million or 19.4% compared to total operating expenses of $149.4 million for the nine months ended September 30, 2009. Total operating expenses, including compensation and employee services expenses, were 41.3% of cash receipts for the nine months ended September 30, 2010, compared to 46.5% for the same period in 2009.

*Compensation and Employee Services*

Compensation and employee services expenses were $91.7 million for the nine months ended September 30, 2010, an increase of $11.8 million or 14.8% compared to compensation and employee services expenses of $79.9 million for the nine months ended September 30, 2009. This increase is mainly due to an increase in our owned portfolio collection staff as well as the hiring of non-collection personnel mainly due to the expansion of our information technology department. Compensation and employee services expenses increased as total employees grew 12.8% to 2,421 as of September 30, 2010 from 2,146 as of September 30, 2009. Compensation and employee services expenses as a percentage of cash receipts decreased to 21.2% for the nine months ended September 30, 2010 from 24.9% of cash receipts for the same period in 2009.

*Legal and Agency Fees and Costs*

Legal and agency fees and costs were $43.6 million for the nine months ended September 30, 2010, an

increase of $9.1 million or 26.4% compared to legal and agency fees and costs of $34.5 million for the nine months ended September 30, 2009. Of the $9.1 million increase, $11.3 million was attributable to an increase in legal fees and costs resulting from accounts referred to both our in-house attorneys and outside independent contingent fee attorneys. This increase was largely due to the refinement of our internal scoring methodology that expanded our account selections for legal action. Growth in the size of our owned debt portfolios and expansion of our internal legal collection resources were also contributing factors. The increase in legal fees and costs was partially offset by a $2.2 million decline in agency fees. Total legal fees paid to independent contingent fee attorneys for the nine months ended September 30, 2010 were 22.3% of external legal cash collections compared to 23.0% for the nine months ended September 30, 2009. These legal fees represent the contingent fees for the cash collections generated by our independent third party attorney network. Total legal costs paid to bring suit on our legal accounts totaled $21.4 million for the nine months ended September 30, 2010 and $11.5 million for the nine months ended September 30, 2009. As a percentage of total legal collections, these legal costs were 23.4% and 18.1% for the nine month periods ended September 30, 2010 and 2009, respectively.

*Outside Fees and Services*

Outside fees and services expenses were $9.5 million for the nine months ended September 30, 2010, an increase of $2.6 million or 37.7% compared to outside fees and services expenses of $6.9 million for the nine months ended September 30, 2009. The $2.6 million increase was attributable to an increase in other outside fees and services and corporate legal expense.

*Communications*

Communications expenses were $13.2 million for the nine months ended September 30, 2010, an increase of $2.0 million or 17.9% compared to communications expenses of $11.2 million for the nine months ended September 30, 2009. The increase was attributable to growth in mailings and higher telephone expenses driven by a greater number of defaulted consumer receivables to work. Mailings were responsible for 90.0% or $1.8 million of this increase, while the remaining 10.0% or $0.2 million was attributable to increased call volumes.

*Rent and Occupancy*

Rent and occupancy expenses were $3.9 million for the nine months ended September 30, 2010, an increase of $0.4 million or 11.4% compared to rent and occupancy expenses of $3.5 million for the nine months ended September 30, 2009. The increase was primarily due to relocation of our IGS business to another location, the expansion of our Hampton, VA call center, the acquisition of CCB and increased utility charges.

*Depreciation and Amortization*

Depreciation and amortization expenses were $9.1 million for the nine months ended September 30, 2010, an increase of $2.2 million or 31.9% compared to depreciation and amortization expenses of $6.9 million for the nine months ended September 30, 2009. The increase is mainly due to additional amortization expense incurred relating to the intangible assets of our newly acquired CCB subsidiary as well as continued capital expenditures on equipment, software, and computers related to our growth and systems upgrades.

*Other Operating Expenses*

Other operating expenses were $7.5 million for the nine months ended September 30, 2010, an increase of $0.9 million or 13.6% compared to other operating expenses of $6.6 million for the nine months ended September 30, 2009. The increase was mainly due to increases in various expenses when compared to the prior year period. No individual item represents a significant portion of the overall increase.

**Interest Income**

Interest income was $35,000 for the nine months ended September 30, 2010, an increase of $32,000 compared to interest income of $3,000 for the nine months ended September 30, 2009. This increase is the result of interest earned and a refund received on the overpayment of federal income taxes.

**Interest Expense**

Interest expense was $6.5 million for the nine months ended September 30, 2010, an increase of $0.6 million compared to interest expense of $5.9 million for the nine months ended September 30, 2009. The increase was mainly due to an increase in our average borrowings under our revolving credit facility for the nine months ended September 30, 2010 compared to the same period in 2009 as well as the interest expense paid during 2010 relating to the interest rate swap, offset by a decrease in our weighted average interest rate which decreased to 2.41% for the nine months ended September 30, 2010 as compared to 2.67% for the nine months ended September 30, 2009.

**Provision for Income Taxes**

Income tax expense was $33.8 million for the nine months ended September 30, 2010, an increase of $13.1 million or 63.3% compared to income tax expense of $20.7 million for the nine months ended September 30, 2009. The increase is mainly due to an increase of 65.5% in income before taxes for the nine months ended September 30, 2010 when compared to the same period in 2009. This was offset by a slight decrease in the effective tax rate of 38.9% for the nine months ended September 30, 2010 compared to 39.4% for the same period in 2009.

**Supplemental Performance Data**

*Owned Portfolio Performance:*

The following tables show certain data related to our owned portfolio. These tables describe the purchase price, cash collections and related multiples. Further, these tables disclose our entire portfolio, the portfolio of purchased bankrupt accounts and our entire portfolio less the impact of our purchased bankrupt accounts. 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 bankruptcy after we purchase them.

The purchase price multiples for 2005 through 2008 described in the table below are lower than historical 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. This was the situation during 2005-2007 and this situation also extended into 2008 to the extent that deals purchased in 2008 were part of forward flow agreements priced in earlier periods.

Additionally however, the way we initially book newly acquired pools of accounts and how we forecast future estimated collections for any given portfolio of accounts has evolved over the years due to a number of factors including the current economic situation. Since our revenue recognition under ASC 310-30 is driven by both 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 pace. Subsequent to the initial booking, as we gain collection experience and comfort with a pool of accounts, we continuously update ERC as time goes on. Since our inception, these processes have tended to cause the ratio of collections, including ERC, to purchase price multiple for any given year of buying to gradually increase over time. As a result, our estimate of lifetime collections to purchase price has shown relatively steady increases as pools have aged. Thus, all factors being equal in terms of pricing, one would naturally tend to see a higher collection to purchase price ratio from a pool of accounts that were six years from purchase than say a pool that was just two years from purchase.

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 extracting additional cash from a discreet quantity and quality of accounts, and/or by extracting cash at a lower cost structure, we can put upward pressure on the collection to purchase price ratio and also on our operating margins. During 2008 and continuing through all of 2009, we made significant enhancements in our analytical abilities, management personnel and automated dialing capabilities, all with the intent to collect more cash at lower cost.

Table of Contents

**Entire Portfolio** ***($ in thousands)***

| Purchase Period | Purchase Price (1) | Total Estimated Collections (2) | Unamortized Purchase Price Balance at September 30, 2010 (3) | Life to Date Reserve Allowance (4) | Percentage of Reserve Allowance to Purchase Price (5) | Percentage of Reserve Allowance to Unamortized Purchase Price and Reserve Allowance (6) | Actual Cash Collections Including Cash Sales | Estimated Remaining Collections (7) | Total Estimated Collections to Purchase Price (8) |
|---|---|---|---|---|---|---|---|---|---|
| 1996 | $ 3,080 | $ 10,094 | $ 0 | $ 0 | 0% | 0% | $ 10,024 | $ 70 | 328% |
| 1997 | $ 7,685 | $ 25,244 | $ 0 | $ 0 | 0% | 0% | $ 25,057 | $ 187 | 328% |
| 1998 | $ 11,089 | $ 36,913 | $ 0 | $ 0 | 0% | 0% | $ 36,506 | $ 407 | 333% |
| 1999 | $ 18,898 | $ 68,282 | $ 0 | $ 0 | 0% | 0% | $ 66,901 | $ 1,381 | 361% |
| 2000 | $ 25,020 | $ 113,442 | $ 0 | $ 0 | 0% | 0% | $ 110,146 | $ 3,296 | 453% |
| 2001 | $ 33,481 | $ 169,035 | $ 0 | $ 0 | 0% | 0% | $ 165,568 | $ 3,467 | 505% |
| 2002 | $ 42,325 | $ 187,309 | $ 0 | $ 0 | 0% | 0% | $ 182,872 | $ 4,437 | 443% |
| 2003 | $ 61,448 | $ 248,438 | $ 0 | $ 0 | 0% | 0% | $ 240,944 | $ 7,494 | 404% |
| 2004 | $ 59,177 | $ 184,196 | $ 462 | $ 1,225 | 2% | 2% | $ 176,311 | $ 7,885 | 311% |
| 2005 | $ 143,171 | $ 309,500 | $ 23,563 | $ 15,985 | 11% | 10% | $ 265,608 | $ 43,892 | 216% |
| 2006 | $ 107,701 | $ 218,553 | $ 29,349 | $ 17,695 | 16% | 14% | $ 163,894 | $ 54,659 | 203% |
| 2007 | $ 258,271 | $ 505,819 | $ 111,183 | $ 17,165 | 7% | 6% | $ 316,096 | $ 189,723 | 196% |
| 2008 | $ 275,130 | $ 538,306 | $ 166,926 | $ 18,895 | 7% | 6% | $ 246,306 | $ 292,000 | 196% |
| 2009 | $ 281,641 | $ 713,656 | $ 213,969 | $ 0 | 0% | 0% | $ 190,109 | $ 523,547 | 253% |
| YTD 2010 | $ 278,266 | $ 585,030 | $ 261,787 | $ 0 | 0% | 0% | $ 47,901 | $ 537,129 | 210% |
| Total | $ 1,606,383 | $ 3,913,817 | $ 807,239 | $ 70,965 | 4% | 4% | $ 2,244,243 | $ 1,669,574 | 244% |

**Purchased Bankruptcy Portfolio** ***($ in thousands)***

| Purchase Period | Purchase Price (1) | Total Estimated Collections (2) | Unamortized Purchase Price Balance at September 30, 2010 (3) | Life to Date Reserve Allowance (4) | Percentage of Reserve Allowance to Purchase Price (5) | Percentage of Reserve Allowance to Unamortized Purchase Price and Reserve Allowance (6) | Actual Cash Collections Including Cash Sales | Estimated Remaining Collections (7) | Total Estimated Collections to Purchase Price (8) |
|---|---|---|---|---|---|---|---|---|---|

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 1996-2003 | $ 0 | $ 0 | $ 0 | $ 0 | 0% | 0% | $ 0 | $ 0 | 0% |
| 2004 | $ 7,469 | $ 14,160 | $ 13 | $ 1,225 | 16% | 14% | $ 14,113 | $ 47 | 190% |
| 2005 | $ 29,302 | $ 43,020 | $ 340 | $ 920 | 3% | 3% | $ 42,577 | $ 443 | 147% |
| 2006 | $ 17,643 | $ 30,450 | $ 269 | $ 1,430 | 8% | 7% | $ 28,321 | $ 2,129 | 173% |
| 2007 | $ 78,933 | $ 112,658 | $ 31,286 | $ 1,910 | 2% | 2% | $ 74,210 | $ 38,448 | 143% |
| 2008 | $ 108,603 | $ 183,195 | $ 72,428 | $ 0 | 0% | 0% | $ 78,709 | $ 104,486 | 169% |
| 2009 | $ 156,094 | $ 360,983 | $ 132,970 | $ 0 | 0% | 0% | $ 75,372 | $ 285,611 | 231% |
| YTD 2010 | $ 172,703 | $ 324,795 | $ 167,846 | $ 0 | 0% | 0% | $ 21,327 | $ 303,468 | 188% |
| Total | $ 570,747 | $ 1,069,261 | $ 405,152 | $ 5,485 | 1% | 1% | $ 334,629 | $ 734,632 | 187% |

**Entire Portfolio Less Purchased Bankruptcy Portfolio *($ in thousands)***

| Purchase Period | Purchase Price [(1)] | Total Estimated Collections [(2)] | Unamortized Purchase Price Balance at September 30, 2010 [(3)] | Life to Date Reserve Allowance [(4)] | Percentage of Reserve Allowance to Purchase Price [(5)] | Percentage of Reserve Allowance to Unamortized Purchase Price and Reserve Allowance [(6)] | Actual Cash Collections Including Cash Sales | Estimated Remaining Collections [(7)] | Total Estimated Collections to Purchase Price [(8)] |
|---|---|---|---|---|---|---|---|---|---|
| 1996 | $ 3,080 | $ 10,094 | $ 0 | $ 0 | 0% | 0% | $ 10,024 | $ 70 | 328% |
| 1997 | $ 7,685 | $ 25,244 | $ 0 | $ 0 | 0% | 0% | $ 25,057 | $ 187 | 328% |
| 1998 | $ 11,089 | $ 36,913 | $ 0 | $ 0 | 0% | 0% | $ 36,506 | $ 407 | 333% |
| 1999 | $ 18,898 | $ 68,282 | $ 0 | $ 0 | 0% | 0% | $ 66,901 | $ 1,381 | 361% |
| 2000 | $ 25,020 | $ 113,442 | $ 0 | $ 0 | 0% | 0% | $ 110,146 | $ 3,296 | 453% |
| 2001 | $ 33,481 | $ 169,035 | $ 0 | $ 0 | 0% | 0% | $ 165,568 | $ 3,467 | 505% |
| 2002 | $ 42,325 | $ 187,309 | $ 0 | $ 0 | 0% | 0% | $ 182,872 | $ 4,437 | 443% |
| 2003 | $ 61,448 | $ 248,438 | $ 0 | $ 0 | 0% | 0% | $ 240,944 | $ 7,494 | 404% |
| 2004 | $ 51,708 | $ 170,036 | $ 449 | $ 0 | 0% | 0% | $ 162,198 | $ 7,838 | 329% |
| 2005 | $ 113,869 | $ 266,480 | $ 23,223 | $ 15,065 | 13% | 12% | $ 223,032 | $ 43,448 | 234% |
| 2006 | $ 90,058 | $ 188,103 | $ 29,080 | $ 16,265 | 18% | 15% | $ 135,572 | $ 52,531 | 209% |
| 2007 | $ 179,338 | $ 393,161 | $ 79,897 | $ 15,255 | 9% | 8% | $ 241,887 | $ 151,274 | 219% |
| 2008 | $ 166,527 | $ 355,111 | $ 94,498 | $ 18,895 | 11% | 10% | $ 167,597 | $ 187,514 | 213% |
| 2009 | $ 125,547 | $ 352,673 | $ 80,999 | $ 0 | 0% | 0% | $ 114,737 | $ 237,936 | 281% |
| YTD 2010 | $ 105,563 | $ 260,235 | $ 93,941 | $ 0 | 0% | 0% | $ 26,573 | $ 233,662 | 247% |
| Total | $ 1,035,636 | $ 2,844,556 | $ 402,087 | $ 65,480 | 6% | 6% | $ 1,909,614 | $ 934,942 | 275% |

(1) Purchase price refers to the cash paid to a seller to acquire defaulted consumer receivables, plus certain capitalized costs, less the purchase price refunded by the seller due to the return of non-compliant accounts (also defined as buybacks). Non-compliant refers to the contractual representations and warranties provided for in the purchase and sale contract between the seller and us. These representations and warranties from the sellers generally cover account holders death or bankruptcy and accounts settled or disputed prior to sale. The seller can

replace or repurchase these accounts.

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

Table of Contents

(3) Unamortized purchase price balance refers to the purchase price less finance receivable amortization over the life of the portfolio.

(4) Life to date reserve allowance refers to the total amount of allowance charges incurred on our owned portfolios net of any reversals.

(5) Percentage of reserve allowance to purchase price refers to the total amount of allowance charges incurred on our owned portfolios net of any reversals, divided by the purchase price.

(6) Percentage of reserve allowance to unamortized purchase price and reserve allowance refers to the total amount of allowance charges incurred on our owned portfolios net of any reversals, divided by the sum of the unamortized purchase price and the life to date reserve allowance.

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

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

The following table shows our net valuation allowances booked since we began accounting for our investment in finance receivables under the guidance of ASC 310-30.

($ in thousands)

| **Allowance** | | | | **Purchase Period** | | | | | **Allowance Charge as % of NFR** |
|---|---|---|---|---|---|---|---|---|---|
| **Period** [1] | **1996-2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2009-2010** | **Total** | [2] |
| Q1 05 | $ | $ | $ | $ | $ | $ | $ | $ | 0.0% |
| Q2 05 | | | | | | | | | 0.0% |
| Q3 05 | | | | | | | | | 0.0% |
| Q4 05 | 200 | | | | | | | 200 | 0.1% |
| Q1 06 | | | 175 | | | | | 175 | 0.1% |
| Q2 06 | 75 | | 125 | | | | | 200 | 0.1% |
| Q3 06 | 200 | | 75 | | | | | 275 | 0.1% |
| Q4 06 | | | 450 | | | | | 450 | 0.2% |
| Q1 07 | (245) | | 610 | | | | | 365 | 0.1% |
| Q2 07 | 90 | | | | | | | 90 | 0.0% |
| Q3 07 | 200 | 320 | 660 | | | | | 1,180 | 0.4% |
| Q4 07 | 190 | 150 | 615 | 340 | | | | 1,295 | 0.3% |
| Q1 08 | 120 | 650 | 910 | 1,105 | | | | 2,785 | 0.6% |
| Q2 08 | 260 | 720 | | 2,330 | 650 | | | 3,960 | 0.8% |
| Q3 08 | (90) | 60 | 325 | 1,135 | 2,350 | | | 3,780 | 0.7% |
| Q4 08 | (400) | (140) | 1,805 | 2,600 | 4,380 | 620 | | 8,865 | 1.6% |
| Q1 09 | (225) | 35 | 1,150 | 910 | 2,300 | 2,050 | | 6,220 | 1.1% |
| Q2 09 | (230) | (220) | 495 | 765 | 685 | 2,425 | | 3,920 | 0.6% |
| Q3 09 | (25) | (190) | 1,170 | 1,965 | 340 | 4,750 | | 8,010 | 1.2% |
| Q4 09 | (120) | | 1,375 | 1,220 | 110 | 6,900 | | 9,485 | 1.4% |
| Q1 10 | | | 2,795 | 1,175 | 2,900 | | | 6,870 | 0.9% |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Q2 10 | | (80) | 1,600 | 2,100 | 700 | 2,000 | | 6,320 | 0.8% |
| Q3 10 | | (80) | 1,650 | 2,050 | 2,750 | 150 | | 6,520 | 0.8% |
| Total | $ | $ 1,225 | $ 15,985 | $ 17,695 | $ 17,165 | $ 18,895 | $ | $ 70,965 | |
| Portfolio Purchases, net | $ 203,026 | $ 59,177 | $ 143,171 | $ 107,701 | $ 258,271 | $ 275,130 | $ 559,907 | $ 1,606,383 | |

(1) Allowance period represents the quarter in which we recorded valuation allowances, net of any (reversals).

(2) NFR refers to total net finance receivables as of the end of the allowance period presented.

Table of Contents

The following graph shows the purchase price of our owned portfolios by year and includes the year to date acquisition amount for the nine months ended September 30, 2010. The purchase price number represents the cash paid to the seller to acquire defaulted consumer receivables, plus certain capitalized costs, less the purchase price refunded by the seller due to the return of non-compliant accounts.

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

The following table, which excludes any proceeds from cash sales of finance receivables, demonstrates our ability to realize significant multi-year cash collection streams on our owned pools:

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

nds)

| Purchase Price | Cash Collection Period | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1996-2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | YTD 2010 |
| 3,080 | $ 7,295 | $ 730 | $ 496 | $ 398 | $ 285 | $ 210 | $ 237 | $ 102 | $ 83 | $ 78 | $ 48 |
| 7,685 | 15,138 | 2,630 | 1,829 | 1,324 | 1,022 | 860 | 597 | 437 | 346 | 215 | 151 |
| 11,089 | 16,981 | 5,152 | 3,948 | 2,797 | 2,200 | 1,811 | 1,415 | 882 | 616 | 397 | 281 |
| 18,898 | 18,207 | 12,090 | 9,598 | 7,336 | 5,615 | 4,352 | 3,032 | 2,243 | 1,533 | 1,328 | 875 |
| 25,020 | 6,894 | 19,498 | 19,478 | 16,628 | 14,098 | 10,924 | 8,067 | 5,202 | 3,604 | 3,198 | 2,093 |
| 33,481 | | 13,048 | 28,831 | 28,003 | 26,717 | 22,639 | 16,048 | 10,011 | 6,164 | 5,299 | 3,317 |
| 42,325 | | | 15,073 | 36,258 | 35,742 | 32,497 | 24,729 | 16,527 | 9,772 | 7,444 | 4,819 |
| 61,448 | | | | 24,308 | 49,706 | 52,640 | 43,728 | 30,695 | 18,818 | 13,135 | 7,915 |
| 59,177 | | | | | 18,019 | 46,475 | 40,424 | 30,750 | 19,339 | 13,677 | 7,622 |
| 143,171 | | | | | | 18,968 | 75,145 | 69,862 | 49,576 | 33,366 | 18,691 |
| 107,701 | | | | | | | 22,971 | 53,192 | 40,560 | 29,749 | 17,422 |
| 258,271 | | | | | | | | 42,263 | 115,011 | 94,805 | 64,017 |
| 275,130 | | | | | | | | | 61,277 | 107,974 | 77,055 |
| 281,641 | | | | | | | | | | 57,338 | 132,771 |
| 278,266 | | | | | | | | | | | 47,901 |
| 1,606,383 | $ 64,515 | $ 53,148 | $ 79,253 | $ 117,052 | $ 153,404 | $ 191,376 | $ 236,393 | $ 262,166 | $ 326,699 | $ 368,003 | $ 384,978 |

Table of Contents

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

($ in thousands)

| Purchase Period | Purchase Price | Cash Collection Period 1996-2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | YTD 2010 | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2004 | $ 7,469 | $ | $ | $ | $ | $ 743 | $ 4,554 | $ 3,956 | $ 2,777 | $ 1,455 | $ 496 | $ 132 | $ 14,113 |
| 2005 | 29,302 | | | | | | 3,777 | 15,500 | 11,934 | 6,845 | 3,318 | 1,203 | 42,577 |
| 2006 | 17,643 | | | | | | | 5,608 | 9,455 | 6,522 | 4,398 | 2,338 | 28,321 |
| 2007 | 78,933 | | | | | | | | 2,850 | 27,972 | 25,630 | 17,758 | 74,210 |
| 2008 | 108,603 | | | | | | | | | 14,024 | 35,894 | 28,791 | 78,709 |
| 2009 | 156,094 | | | | | | | | | | 16,635 | 58,737 | 75,372 |
| YTD 2010 | 172,703 | | | | | | | | | | | 21,327 | 21,327 |
| Total | $ 570,747 | $ | $ | $ | $ | $ 743 | $ 8,331 | $ 25,064 | $ 27,016 | $ 56,818 | $ 86,371 | $ 130,286 | $ 334,629 |

**Cash Collections By Year, By Year of Purchase   Entire Portfolio less Purchased Bankruptcy Portfolio**

nds)

| Purchase Price | Cash Collection Period 1996-2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | YTD 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 3,080 | $ 7,295 | $ 730 | $ 496 | $ 398 | $ 285 | $ 210 | $ 237 | $ 102 | $ 83 | $ 78 | $ 48 |
| 7,685 | 15,138 | 2,630 | 1,829 | 1,324 | 1,022 | 860 | 597 | 437 | 346 | 215 | 151 |
| 11,089 | 16,981 | 5,152 | 3,948 | 2,797 | 2,200 | 1,811 | 1,415 | 882 | 616 | 397 | 281 |
| 18,898 | 18,207 | 12,090 | 9,598 | 7,336 | 5,615 | 4,352 | 3,032 | 2,243 | 1,533 | 1,328 | 875 |
| 25,020 | 6,894 | 19,498 | 19,478 | 16,628 | 14,098 | 10,924 | 8,067 | 5,202 | 3,604 | 3,198 | 2,093 |
| 33,481 | | 13,048 | 28,831 | 28,003 | 26,717 | 22,639 | 16,048 | 10,011 | 6,164 | 5,299 | 3,317 |
| 42,325 | | | 15,073 | 36,258 | 35,742 | 32,497 | 24,729 | 16,527 | 9,772 | 7,444 | 4,819 |
| 61,448 | | | | 24,308 | 49,706 | 52,640 | 43,728 | 30,695 | 18,818 | 13,135 | 7,915 |
| 51,708 | | | | | 17,276 | 41,921 | 36,468 | 27,973 | 17,884 | 13,181 | 7,490 |
| 113,869 | | | | | | 15,191 | 59,645 | 57,928 | 42,731 | 30,048 | 17,489 |
| 90,058 | | | | | | | 17,363 | 43,737 | 34,038 | 25,351 | 15,083 |
| 179,338 | | | | | | | | 39,413 | 87,039 | 69,175 | 46,260 |
| 166,527 | | | | | | | | | 47,253 | 72,080 | 48,264 |
| 125,547 | | | | | | | | | | 40,703 | 74,034 |
| 105,563 | | | | | | | | | | | 26,573 |
| 1,035,636 | $ 64,515 | $ 53,148 | $ 79,253 | $ 117,052 | $ 152,661 | $ 183,045 | $ 211,329 | $ 235,150 | $ 269,881 | $ 281,632 | $ 254,692 |

When we acquire a new pool of finance receivables, our estimates typically result in an 84   96 month projection of cash collections. 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.

Table of Contents

*Owned Portfolio Personnel Performance:*

We measure the productivity of each collector each month, breaking results into groups of similarly tenured collectors. The following tables display various productivity measures that we track.

**Number of Collectors by Tenure**

| | | | One year +(1) | | | |
|---|---|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** |
| **Q1** | 319 | 331 | 340 | 314 | 488 | 690 |
| **Q2** | 319 | 342 | 360 | 348 | 587 | 711 |
| **Q3** | 324 | 324 | 397 | 410 | 604 | 742 |
| **Q4** | 327 | 340 | 327 | 452 | 638 | |

| | | | Less than one year(2) | | | |
|---|---|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** |
| **Q1** | 345 | 360 | 435 | 688 | 621 | 686 |
| **Q2** | 330 | 372 | 481 | 744 | 612 | 681 |
| **Q3** | 268 | 402 | 475 | 631 | 585 | 642 |
| **Q4** | 364 | 375 | 553 | 739 | 676 | |

| | | | Total(2) | | | |
|---|---|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** |
| **Q1** | 664 | 691 | 775 | 1,002 | 1,109 | 1,376 |
| **Q2** | 649 | 714 | 841 | 1,092 | 1,199 | 1,392 |
| **Q3** | 592 | 726 | 872 | 1,041 | 1,189 | 1384 |
| **Q4** | 691 | 715 | 880 | 1,191 | 1,314 | |

(1) Calculated based on actual employees (collectors) with one year of service or more.

(2) Calculated using total hours worked by all collectors, including those in training to produce a full time equivalent FTE.

The tables below contain our past five years of collector productivity metrics as defined by calendar quarter.

**QTD Cash Collections per Hour Paid** (1)

| | | | Total cash collections | | | |
|---|---|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** |
| Q1 | $136 | $152 | $156 | $133 | $147 | $182 |
| Q2 | $138 | $146 | $142 | $136 | $143 | $188 |
| Q3 | $135 | $145 | $131 | $134 | $144 | $200 |
| Q4 | $126 | $142 | $119 | $123 | $148 | |

| | | | Non-legal cash collections(2) | | | |
|---|---|---|---|---|---|---|
| | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** |
| Q1 | $96 | $106 | $108 | $96 | $118 | $154 |
| Q2 | $92 | $99 | $96 | $99 | $116 | $160 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Q3 | $88 | $98 | $88 | $99 | $119 | $170 |
| Q4 | $82 | $94 | $80 | $94 | $123 | |

**Non-bankruptcy cash collections(3)**

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| Q1 | $132 | $141 | $141 | $116 | $120 | $135 |
| Q2 | $132 | $132 | $129 | $115 | $114 | $127 |
| Q3 | $129 | $129 | $120 | $110 | $111 | $127 |
| Q4 | $120 | $127 | $107 | $98 | $109 | |

**Non-legal/non-bankruptcy cash collections(4)**

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| Q1 | $92 | $95 | $92 | $79 | $90 | $106 |
| Q2 | $85 | $85 | $83 | $78 | $87 | $100 |
| Q3 | $82 | $82 | $76 | $76 | $87 | $97 |
| Q4 | $77 | $80 | $68 | $69 | $84 | |

(1) Cash collections (assigned and unassigned) divided by total hours paid (including holiday, vacation and sick time) to collectors (including those in training).

(2) Represents total cash collections less external legal cash collections.

(3) Represents total cash collections less purchased bankruptcy cash collections from trustee-administered accounts.

(4) Represents total cash collections less external legal cash collections and less purchased bankruptcy cash collections from trustee-administered accounts.

Cash collections have substantially exceeded income recognized on finance receivables in each quarter since our formation. The following chart illustrates the consistent excess of our cash collections on our owned portfolios over the income recognized on finance receivables, net on a quarterly basis. The difference between cash collections and income recognized is referred to as payments applied to principal. It is also referred to as finance receivable amortization. This finance receivable 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

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

| Cash Collection Source ($ in thousands) | Q32010 | Q22010 | Q12010 | Q42009 | Q32009 | Q22009 | Q12009 | Q42008 | Q32008 |
|---|---|---|---|---|---|---|---|---|---|
| Call Center & Other Collections | $ 51,711 | $ 54,477 | $ 56,987 | $ 45,365 | $ 48,590 | $ 50,052 | $ 50,914 | $ 41,268 | $ 43,949 |
| External Legal Collections | 20,217 | 18,819 | 18,276 | 15,496 | 15,330 | 16,527 | 17,790 | 18,424 | 21,590 |
| Internal Legal Collections | 12,130 | 11,362 | 10,714 | 7,570 | 6,196 | 4,263 | 3,539 | 2,652 | 2,106 |
| Purchased Bankruptcy Collections | 53,319 | 43,748 | 33,219 | 26,855 | 22,251 | 19,637 | 17,628 | 16,904 | 15,362 |

*Rollforward of Net Finance Receivables*

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

| | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2010 | Nine Months Ended September 30, 2009 |
|---|---|---|---|---|
| Balance at beginning of period | $ 775,606 | $ 624,592 | $ 693,462 | $ 563,830 |
| Acquisitions of finance receivables, net of buybacks (1) | 88,984 | 74,318 | 273,858 | 210,116 |
| Cash collections applied to principal on finance receivables (2) | (57,351) | (38,031) | (160,081) | (113,067) |
| Balance at end of period | $ 807,239 | $ 660,879 | $ 807,239 | $ 660,879 |
| Estimated Remaining Collections ( ERC ) (3) | $ 1,669,574 | $ 1,331,912 | $ 1,669,574 | $ 1,331,912 |

(1) Agreements to purchase receivables typically include general representations and warranties from the sellers covering account holders death or bankruptcy and accounts settled or disputed prior to sale. The seller can replace or repurchase these accounts. We refer to repurchased accounts as buybacks. We also capitalize certain acquisition related costs.

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

(3) Estimated Remaining Collections refers to the sum of all future projected cash collections on our owned portfolios. ERC is not a balance sheet item; however, it is provided here for informational purposes.

*Seasonality*

We depend on the ability to collect on our owned and serviced defaulted consumer receivables. Cash 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 consumer payment patterns in connection with seasonal employment trends, income tax refunds and holiday spending habits. Historically, our growth has partially masked the impact of this cash collections seasonality.

Table of Contents

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

*Portfolios by Type and Geography*

The following table categorizes our life to date owned portfolios at September 30, 2010 into the major asset types represented (amounts in thousands):

| **Asset Type** | **No. of Accounts** | **%** | | **Life to Date Purchased Face Value of Defaulted Consumer Receivables (1)** | **%** |
|---|---|---|---|---|---|
| Major Credit Cards | 14,220 | 59.8% | $ | 38,321,385 | 72.3% |
| Consumer Finance | 5,285 | 22.2% | | 6,195,641 | 11.7% |
| Private Label Credit Cards | 3,776 | 15.9% | | 5,171,199 | 9.8% |
| Auto Deficiency | 510 | 2.1% | | 3,278,611 | 6.2% |
| **Total:** | **23,791** | **100.0%** | **$** | **52,966,836** | **100.0%** |

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

The following chart shows details of our life to date buying activity as of September 30, 2010 (amounts in thousands). We actively seek to purchase both bankrupt and non-bankrupt accounts at any point in the delinquency cycle.

| **Account Type** | **No. of Accounts** | **%** | | **Life to Date Purchased Face Value of Defaulted Consumer Receivables (1)** | **%** |
|---|---|---|---|---|---|
| Fresh | 1,320 | 5.5% | $ | 4,109,213 | 7.8% |
| Primary | 3,620 | 15.2% | | 6,212,667 | 11.7% |
| Secondary | 3,825 | 16.1% | | 6,121,552 | 11.6% |
| Tertiary | 3,937 | 16.5% | | 5,017,483 | 9.5% |
| BK Trustees | 3,439 | 14.5% | | 15,174,713 | 28.6% |
| Other | 7,650 | 32.2% | | 16,331,208 | 30.8% |
| **Total:** | **23,791** | **100.0%** | **$** | **52,966,836** | **100.0%** |

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

We also review the geographic distribution of accounts within a portfolio because we have found that certain states have more debtor-friendly laws than others and, therefore, are less desirable from a collectability perspective. In addition, economic factors and bankruptcy trends vary regionally and are factored into our maximum purchase price equation.

The following chart sets forth our overall life to date portfolio of defaulted consumer receivables geographically at September 30, 2010 (amounts in thousands):

Table of Contents

| Geographic Distribution | No. of Accounts | % | | Life to Date Purchased Face Value of Defaulted Consumer Receivables (1) | % | | Original Purchase Price of Defaulted Consumer Receivables (2) | % |
|---|---|---|---|---|---|---|---|---|
| California | 2,444 | 10% | $ | 6,799,417 | 13% | $ | 197,164 | 12% |
| Texas | 3,768 | 16% | | 6,118,228 | 12% | | 153,383 | 9% |
| Florida | 1,864 | 8% | | 5,059,455 | 10% | | 145,930 | 9% |
| New York | 1,401 | 6% | | 3,283,264 | 6% | | 94,105 | 6% |
| Pennsylvania | 830 | 3% | | 2,014,301 | 4% | | 64,247 | 4% |
| North Carolina | 842 | 4% | | 1,865,383 | 4% | | 55,885 | 3% |
| Illinois | 935 | 4% | | 1,852,381 | 3% | | 62,859 | 4% |
| Ohio | 825 | 3% | | 1,842,272 | 3% | | 68,544 | 4% |
| Georgia | 748 | 3% | | 1,708,829 | 3% | | 64,948 | 4% |
| New Jersey | 552 | 2% | | 1,512,003 | 3% | | 47,417 | 3% |
| Michigan | 632 | 3% | | 1,432,679 | 3% | | 50,993 | 3% |
| Virginia | 655 | 3% | | 1,141,459 | 2% | | 39,343 | 2% |
| Tennessee | 501 | 2% | | 1,105,474 | 2% | | 41,156 | 3% |
| Arizona | 399 | 2% | | 1,070,902 | 2% | | 31,577 | 2% |
| Massachusetts | 423 | 2% | | 1,023,540 | 2% | | 30,855 | 2% |
| South Carolina | 416 | 2% | | 946,733 | 2% | | 27,430 | 2% |
| Other (3) | 6,556 | 27% | | 14,190,516 | 26% | | 466,934 | 28% |
| **Total:** | **23,791** | **100%** | **$** | **52,966,836** | **100%** | **$** | **1,642,770** | **100%** |

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

(2) The Original Purchase Price of Defaulted Consumer Receivables 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.

**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 September 30, 2010, cash and cash equivalents totaled $20.3 million, consistent with the amount as of December 31, 2009. Total debt outstanding on our $365 million line of credit was $288.5 million as of September 30, 2010, which represents availability of $76.5 million.

We have in place forward flow commitments for the purchase of defaulted consumer receivables over the next 12 months of approximately $104.8 million as of September 30, 2010. 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 current 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, due to these opportunities, we continue to work with our current bank group and others on a new and expanded syndicated loan facility with a goal of closing on an increased syndicated line of credit during the fourth quarter of 2010, but no later than the expiration of our current facility. We are seeking to increase the total line to approximately $400 to $450 million. Based on current market conditions, we expect the interest rate on a new, expanded revolving floating rate line of credit will be higher than the rate on our current revolving floating rate line of credit. Borrowings under the current revolving floating rate line of credit bear interest at a

floating rate equal to the one month LIBOR Market Index Rate plus 1.40%, which equated to 1.66% at September 30, 2010. Based on initial indications, the interest rate on a new, expanded line of credit, if consummated, could increase to the one month LIBOR Market Index Rate plus approximately 2.75%, which equated to 3.01% at September 30, 2010. 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 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 in any scenario is $22.8 million.

We file income taxes using the cost recovery method for tax revenue recognition. We were notified on June 21, 2007 that we were being examined by the Internal Revenue Service for the 2005 calendar year. The IRS has concluded its 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 proposed 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. 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 our appeal, we may ultimately be required to pay the related deferred taxes and any potential interest, possibly requiring additional financing from other sources.

Cash generated from operations is dependent upon our ability to collect on our defaulted consumer 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 expected future cash flows.

Our operating activities provided cash of $103.4 million and $64.2 million for the nine months ended September 30, 2010 and 2009, 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 increase was due mostly to changes in deferred taxes and an increase in net income to $53.2 million for the nine months ended September 30, 2010 from $31.9 million for the nine months ended September 30, 2009. The remaining changes were due to net changes in other accounts related to our operating activities.

Our investing activities used cash of $143.0 million and $100.2 million during the nine months ended September 30, 2010 and 2009, 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 cash payments for business acquisitions totaling $23.1 million during the nine months ended September 30, 2010, as compared to $100,000 during the nine months ended September 30, 2009, as well as an increase in acquisitions of finance receivables, which increased from $210.1 million for the nine months ended September 30, 2009 to $273.9 million for the nine months ended September 30, 2010, partially offset by an increase in collections applied to principal on finance receivables from $113.1 million for the nine months ended September 30, 2009 to $160.1 million for the nine months ended September 30, 2010.

Our financing activities provided cash of $39.7 million and $42.0 million during the nine months ended September 30, 2010 and 2009, 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 payments on our line of credit and principal payments on long-term debt and capital lease obligations. The majority of the increase was due to cash proceeds received from our $75.5 million equity offering during the nine months ended September 30, 2010, partially offset by $30.8 million in net repayments on our line of credit during the nine months ended September 30, 2010, as compared to net borrowings on our line of credit of $38.0 million during the same period in 2009.

Cash paid for interest was $6.5 million and $6.0 million for the nine months ended September 30, 2010 and 2009, respectively. Interest was paid on our line of credit, long-term debt, capital lease obligations and our interest rate swap

agreement. The increase was mainly due to an increase in our average borrowings for the nine months

ended September 30, 2010 compared to the same period in 2009 as well as the interest expense paid during 2010 relating to the interest rate swap, offset by a decrease in our weighted average interest rate which decreased to 2.41% for the nine months ended September 30, 2010 as compared to 2.67% for the nine months ended September 30, 2009.

*Borrowings*

On November 29, 2005, we entered into a Loan and Security Agreement for a revolving line of credit. The agreement has been amended six times to add additional lenders and ultimately increase the total availability of credit under the line to $365 million. The agreement is a line of credit in an amount equal to the lesser of $365 million or 30% of our ERC of all our eligible asset pools. Borrowings under the revolving credit facility bear interest at a floating rate equal to the one month LIBOR Market Index Rate plus 1.40%, which equated to 1.66% at September 30, 2010. Of the $365 million facility, $50 million was locked in as an interest only term loan at a rate of 6.80% and expires on May 4, 2012. The remaining $315 million expires on May 2, 2011. We also pay an unused line fee equal to three-tenths of one percent, or 30 basis points, on any unused portion of the line of credit. The loan is collateralized by substantially all our tangible and intangible assets. The agreement provides as follows:

- monthly borrowings may not exceed 30% of ERC;

- funded debt to EBITDA (defined as net income, less income or plus loss from discontinued operations and extraordinary items, plus income taxes, plus interest expense, plus depreciation, depletion, amortization (including finance receivable amortization) and other non-cash charges) ratio must be less than 2.0 to 1.0 calculated on a rolling twelve-month average;

- tangible net worth must be at least 100% of tangible net worth reported at September 30, 2005, plus 25% of cumulative positive net income since the end of such fiscal quarter, plus 100% of the net proceeds from any equity offering without giving effect to reductions in tangible net worth due to repurchases of up to $100,000,000 of our common stock; and

- restrictions on change of control.

As of September 30, 2010 and 2009, outstanding borrowings under the facility totaled $288.5 million and $306.3 million, respectively, of which $50.0 million was part of the non-revolving fixed rate sub-limit. The average balance on the revolving portion of the credit facility for the three months ended September 30, 2010 and 2009 was $246.7 million and $238.8 million, respectively. As of September 30, 2010, we were in compliance with all of the covenants of the agreement.

Other borrowings at September 30, 2010, consisted of $1.0 million of long-term debt which matures on February 28, 2012.

*Stockholders Equity*

Stockholders equity was $468.5 at September 30, 2010 and $335.5 million at December 31, 2009. The increase was attributable primarily to $71.7 in net proceeds from a stock offering and $52.8 million in net income.

**Contractual Obligations**

Our contractual obligations as of September 30, 2010 were as follows (amounts in thousands):

| | | **Payments due by period** | | | |
|---|---|---|---|---|---|
| **Contractual Obligations** | **Total** | **Less than 1 year** | **1 - 3 years** | **4 - 5 years** | **More than 5 years** |
| Operating Leases | $ 20,097 | $ 4,083 | $ 8,178 | $ 5,416 | $ 2,420 |
| Line of Credit [1] | 297,106 | 245,123 | 51,983 | | |
| Long-term Debt | 1,034 | 730 | 304 | | |
| Purchase Commitments [2] [3] | 130,976 | 108,001 | 15,375 | 7,600 | |
| Employment Agreements | 10,160 | 8,359 | 1,647 | 154 | |

| | | | | | |
|---|---|---|---|---|---|
| Total | $ 459,373 | $ 366,296 | $ 77,487 | $ 13,170 | $ 2,420 |

(1) To the extent that a balance is outstanding on our lines of credit, the revolving portion would be due in May, 2011 and the non-revolving fixed rate sub-limit portion would be due in May 2012. 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 as well as interest due on our interest rate swap. This estimate also assumes that the balance on the line of credit remains constant from the September 30, 2010 balance of $288.5 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 $104.8 million.

(3) This amount includes $1.0 million of remaining consideration to be paid relating to the acquisition of CCB as well as 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**

In June 2009, the FASB issued guidance on accounting for transfers of financial assets to improve the reporting for the transfer of financial assets. The guidance must be applied as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. We adopted this guidance during the first quarter of 2010, which had no material impact on our consolidated financial statements.

In June 2009, the FASB issued guidance on consolidation of variable interest entities to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. The guidance is effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. We adopted this guidance during the first quarter of 2010, which had no material impact on our consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements ( ASU 2010-06 ), which clarifies and expands disclosure requirements related to fair value measurements. Disclosures are required for significant transfers between levels in the fair value hierarchy. Activity in Level 3 fair value measurements is to be presented on a gross, rather than net, basis. The update clarifies how the appropriate level of disaggregation should be determined and emphasizes that information sufficient to permit reconciliation between fair value measurements and line items on the financial statements should be provided. The update is effective for interim and annual reporting periods beginning after December 15, 2009 except for the expanded disclosures related to activity in Level 3 fair value measurements which are effective one year later. We adopted ASU 2010-06 during the first quarter of 2010, which had no material effect on our consolidated financial statements.

In April 2010, the FASB issued ASU No. 2010-18, Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool that is Accounted for as a Single Asset ( ASU 2010-18 ), which clarifies the accounting for acquired loans that have evidence of a deterioration in credit quality since origination (referred to as Subtopic 310-30 Loans ). Under ASU 2010-18, an entity may not apply troubled debt restructuring ( TDR ) accounting guidance to individual Subtopic 310-30 loans that are part of a pool, even if the modification of those loans would otherwise be considered a troubled debt restructuring. Once a pool is established, individual loans should not be removed from the pool unless the entity sells, forecloses, or writes off the loan. Entities would continue to consider whether the pool of loans is impaired if expected cash flows for the pool change. Subtopic 310-30 loans that are accounted for individually would continue to be subject to TDR accounting guidance. A one-time election to terminate accounting for loans as a pool, which may be made on a pool-by-pool basis, is provided upon adoption of ASU 2010-18. ASU 2010-18 is

effective for interim or annual periods ending on or after July 15, 2010. We adopted ASU 2010-18 during the third quarter of 2010, which had no material effect on our consolidated financial statements.

Table of Contents

In July, 2010, the FASB issued ASU No. 2010-20, Receivables (Topic 310) Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses ( ASU 2010-20 ), which requires significant new disclosures about the allowance for credit losses and the credit quality of financing receivables. The requirements are intended to enhance transparency regarding credit losses and the credit quality of loan and lease receivables. Under this statement, allowance for credit losses and fair value are to be disclosed by portfolio segment, while credit quality information, impaired financing receivables and nonaccrual status are to be presented by class of financing receivable. Disclosure of the nature and extent, the financial impact and segment information of troubled debt restructurings will also be required. The disclosures are to be presented at the level of disaggregation that management uses when assessing and monitoring the portfolio s risk and performance. ASU 2010-20 is effective for interim and annual reporting periods ending on or after December 15, 2010. The adoption of ASU 2010-20 is not expected to have a material effect on our consolidated financial statements.

**Critical Accounting Policies**

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles and our discussion and analysis of our financial condition and results of operations require our management to make judgments, assumptions, and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates and such differences 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*

We acquire accounts that have experienced deterioration of credit quality between origination and our acquisition of the accounts. The amount paid for an account reflects our determination that it is probable we will be unable to collect all amounts due according to the account s contractual terms. At acquisition, we review each account 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 amounts due according to the account s contractual terms. If both conditions exist, we 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 for each acquired portfolio and subsequently aggregated pools of accounts. 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) based on our proprietary acquisition models. The remaining amount, representing the excess of the account s cash flows expected to be collected over the amount paid, is accreted into income recognized on finance receivables over the remaining life of the account or pool (accretable yield).

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). 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, principal payments 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 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. ASC 310-30, utilizing the interest method, initially freezes the yield, estimated when the accounts are purchased as the basis for subsequent

impairment testing. Significant increases in expected future cash flows may be recognized prospectively through an upward adjustment of the yield over a portfolio 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 sheet. Income on finance receivables is accrued quarterly based on each static pool s effective yield. 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 finance receivable amortization). Likewise, cash flows that are less than the interest accrual will accrete the carrying balance. Generally, we do not allow accretion in the first six to twelve months; accordingly, we utilize either the cost recovery method or cash method when necessary to prevent accretion as permitted by ASC 310-30. The yield is estimated and periodically recalculated based on the timing and amount of anticipated cash flows using our proprietary collection models. 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. Under the cash method, revenue is recognized as it would be under the interest method up to the amount of cash collections. 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 portfolios. Under the cost recovery method, no revenue is recognized until we have fully collected the cost of the portfolio, 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 for all acquired accounts subject to ASC 310-30 to reflect only those losses incurred after acquisition (that is, the present value of cash flows initially expected at acquisition that are no longer expected to be collected). Valuation allowances are established only subsequent to acquisition of the accounts. At September 30, 2010, we had a $71.0 million valuation allowance on our finance receivables.

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 accounting pool watching for trends, actual performance versus projections and curve shape, 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 staffs may also be involved depending upon actual cash flow results achieved. 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), 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 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.

We utilize the provisions ASC Topic 605-45, Principal Agent Considerations ( ASC 605-45 ), to account for revenues 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, who controls vendor selection, who establishes pricing and who 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, primarily because we are primarily liable to the third party collector. There is a

corresponding expense in Legal and agency fees and costs 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 Legal and agency fees and costs.

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 we conduct an audit, there are two components. The first component is a charge for the hours incurred on conducting the audit. This charge is for hours worked. This charge is up-charged 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 receive the related settlement payment. Under SEC Staff Accounting Bulletin 104, ( SAB 104 ), we have determined 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, we record our fee on a net basis as revenue and include it in the line item Fee income. The balance of the received amounts are recorded as a liability and included in the line item Accrued expenses and other liabilities.

*Valuation of Acquired Intangibles and Goodwill*

In accordance with ASC Topic 350, Intangibles Goodwill and Other ( ASC 350 ), we are required to perform a review of goodwill 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.

We believe that, at September 30, 2010, there were no indicators of potential impairment of goodwill. Therefore, no early review of goodwill for impairment was performed. However, changes in various circumstances including changes in our market capitalization, changes in our forecasts and changes in our internal business structure could cause one of our reporting units to be valued differently thereby causing an impairment of goodwill. Additionally, in response to changes in our industry and changes in global or regional economic conditions, we may strategically realign our resources and consider restructuring, disposing or otherwise exiting businesses, which could result in an impairment of some or all of our identifiable intangibles or goodwill.

*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 bases 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 guidance also 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. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. 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 50 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.

Effective with our 2002 tax filings, we adopted 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 and results in the reduction of current taxable income as, for tax purposes, collections on finance receivables are applied first to principal to reduce the finance receivables to zero before any income is recognized.

We believe it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. 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**

Our exposure to market risk relates to interest rate risk with our variable rate credit line. The average borrowings on our variable rate credit line were $246.7 million and $238.8 million for the three months ended September 30, 2010 and 2009, respectively. Assuming a 200 basis point increase in interest rates, interest expense would have increased by $1.2 million for the three months ended September 30, 2010 and 2009, respectively. At September 30, 2010 and 2009, we had $238.5 million and $256.3 million, respectively, of variable rate debt outstanding on our credit line. We do not have any other variable rate debt outstanding at September 30, 2010. 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.

**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 principal executive

officer and principal financial 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 principal executive officer and principal financial officer have concluded that, as of September 30, 2010, 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 September 30, 2010 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 consumers and are occasionally countersued by them in such actions. Also, consumers, either individually, as members of a class action, or through a governmental entity on behalf of consumers, 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. We maintain appropriate levels of errors and omissions insurance coverage to protect us against financial losses associated with potential litigation involving us, and while it is not expected that these or any other legal proceedings or claims in which we are involved will, either individually or in the aggregate, have a material adverse impact on our results of operations, liquidity or our financial condition, the matters described below falls outside of the normal parameters of our routine legal proceedings.

We are currently a defendant in a purported class action counterclaim entitled PRA v. Barkwell, 4:09-cv-00113-CDL, which was filed in response to a motion filed by PRA that sought to confirm an arbitration award, in the amount of $9,781.43. The counterclaim, which was filed against us, the National Arbitration Forum ( NAF ) and MBNA America Bank, N.A., on July 29, 2009 in the Superior Court of Muscogee County, Georgia, and has since been removed to the United States District Court for the Middle District of Georgia, where it is currently pending. The counterclaim alleges that in pursuing arbitration claims against Barkwell and other consumer debtors, pursuant to the terms and conditions of their respective cardholder agreements, we breached a duty of good faith and fair dealing and made negligent misrepresentations concerning its arbitration practices. The counterclaim asserts that because NAF was financially tied to Axiant, LLC, a large, nationwide debt collector, NAF lacked the necessary independence and impartiality to conduct arbitration proceedings, such as the ones filed by PRA, including the arbitration claim that was filed against Mr. Barkwell. Barkwell asserts that PRA knew, or should have known, of the relationship between NAF and Axiant, and brought this action on behalf of a purported class of consumers to, among other things, vacate the arbitration awards that we have obtained before NAF and have us disgorge the amounts collected with respect to such awards. While it is not possible at this time to accurately estimate the possible loss, if any, as we believe we have meritorious defenses to the allegations made in this counterclaim and intend to defend ourselves vigorously against them. This matter has not progressed to the discovery stage yet, therefore the Company currently lacks the necessary information to determine the aggregate amount of arbitration claims potentially impacted by the purported class herein.

As previously disclosed, we are a defendant in another purported class action related to matters previously brought before NAF, styled PRA v. Freeman (Case No.: 10-CVD-1003) which was filed in the District Court for Wake County, North Carolina on or about March 26, 2010. The court in PRA v. Freeman recently heard arguments on the motion to dismiss that the Company had filed earlier this year and has informed the parties that the matter will be dismissed, pending submission of an appropriate order. We anticipate submitting such an order and having the matter dismissed imminently.

As previously disclosed, we were a defendant in a purported enforcement action brought by the Attorney General for the State of Missouri. The action, filed in August 2009, sought relief for Missouri consumers that had allegedly been injured as a result of certain of our alleged collection practices. We denied any wrongdoing with respect to the allegations in the complaint and on June 25, 2010, the Missouri Circuit Court dismissed the matter in its entirety. On July 26, 2010, the Missouri Attorney General filed a notice of appeal.

Table of Contents

**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 2009 Annual Report on Form 10-K filed on February 16, 2010, 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.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Other Information**

None.

**Item 5. Exhibits**

31.1 Section 302 Certifications of Chief Executive Officer.

31.2 Section 302 Certifications of Chief Financial Officer.

32.1 Section 906 Certifications of Chief Executive Officer and Chief Financial Officer.

**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: November 9, 2010

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

Date: November 9, 2010

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)