Live Oak Bancshares, Inc.
Form 10-Q
November 07, 2018

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2018
or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to .
Commission file number: 001-37497
LIVE OAK BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

North Carolina	26-4596286
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1741 Tiburon Drive Wilmington, North Carolina	28403
(Address of principal executive offices)	(Zip Code)

(910) 790-5867
(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 ý NO ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES ý NO ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	x

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO ý
APPLICABLE ONLY TO CORPORATE ISSUERS:
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of November 6, 2018, there were 35,503,535 shares of the registrant’s voting common stock outstanding and 4,643,530 shares of the registrant’s non-voting common stock outstanding.

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Live Oak Bancshares, Inc. and Subsidiaries
Form 10-Q
For the Quarterly Period Ended September 30, 2018
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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
Live Oak Bancshares, Inc.
Condensed Consolidated Balance Sheets
As of September 30, 2018 (unaudited) and December 31, 2017*
(Dollars in thousands)

	September 30, 2018	December 31, 2017*
Assets		
Cash and due from banks	$368,565	$295,271
Certificates of deposit with other banks	750	3,000
Investment securities available-for-sale	374,284	93,355
Loans held for sale	646,475	680,454
Loans and leases held for investment	1,631,337	1,343,973
Allowance for loan and lease losses	(26,797)	(24,190)
Net loans and leases	1,604,540	1,319,783
Premises and equipment, net	263,861	178,790
Foreclosed assets	1,429	1,281
Servicing assets	49,261	52,298
Other assets	135,592	134,242
Total assets	$3,444,757	$2,758,474
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Noninterest-bearing	$48,622	$57,868
Interest-bearing	2,875,666	2,202,395
Total deposits	2,924,288	2,260,263
Long term borrowings	1,506	26,564
Other liabilities	41,733	34,714
Total liabilities	2,967,527	2,321,541
Shareholders' equity		
Preferred stock, no par value, 1,000,000 authorized, none issued or outstanding at September 30, 2018 and December 31, 2017	—	—
Class A common stock, no par value, 100,000,000 shares authorized, 35,496,887 and 35,252,053 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	276,831	268,557
Class B common stock, no par value, 10,000,000 shares authorized, 4,643,530 shares issued and outstanding at September 30, 2018 and December 31, 2017	49,168	49,168
Retained earnings	157,839	120,241
Accumulated other comprehensive loss	(6,608)	(1,033)
Total equity	477,230	436,933
Total liabilities and shareholders' equity	$3,444,757	$2,758,474

* Derived from audited consolidated financial statements.
See Notes to Unaudited Condensed Consolidated Financial Statements

Live Oak Bancshares, Inc.
Condensed Consolidated Statements of Income
For the three and nine months ended September 30, 2018 and 2017 (unaudited)
(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest income				
Loans and fees on loans	$37,724	$26,977	$106,682	$70,290
Investment securities, taxable	2,528	325	6,175	964
Other interest earning assets	1,638	870	5,032	1,682
Total interest income	41,890	28,172	117,889	72,936
Interest expense				
Deposits	14,165	6,758	38,510	16,893
Borrowings	1	389	131	985
Total interest expense	14,166	7,147	38,641	17,878
Net interest income	27,724	21,025	79,248	55,058
Provision for (recovery of) loan and lease losses	(243)	2,426	6,236	5,481
Net interest income after provision for loan and lease losses	27,967	18,599	73,012	49,577
Noninterest income				
Loan servicing revenue	7,506	6,490	21,369	18,587
Loan servicing asset revaluation	(9,380)	(3,691)	(18,138)	(6,864)
Net gains on sales of loans	22,004	18,148	69,483	55,276
Lease income	2,194	682	5,722	691
Construction supervision fee income	578	362	1,954	1,077
Title insurance income	479	1,968	2,775	5,803
Other noninterest income	950	1,101	2,535	2,910
Total noninterest income	24,331	25,060	85,700	77,480
Noninterest expense				
Salaries and employee benefits	20,553	19,037	62,908	55,687
Travel expense	2,003	2,289	5,887	6,035
Professional services expense	1,228	1,068	3,645	4,228
Advertising and marketing expense	1,462	1,516	4,992	4,977
Occupancy expense	1,588	1,473	5,327	4,018
Data processing expense	3,661	1,982	9,404	5,536
Equipment expense	3,649	2,228	10,094	5,005
Other loan origination and maintenance expense	1,742	1,601	4,485	3,587
FDIC insurance	1,105	858	2,687	2,308
Title insurance closing services expense	114	687	912	1,877
Impairment expense on goodwill and other intangibles, net	2,680	—	2,680	—
Other expense	1,459	3,117	7,125	8,883
Total noninterest expense	41,244	35,856	120,146	102,141
Income before taxes	11,054	7,803	38,566	24,916
Income tax benefit	(3,198)	(5,059)	(2,392)	(3,853)
Net income	$14,252	$12,862	$40,958	$28,769
Basic earnings per share	$0.36	$0.34	$1.02	$0.81
Diluted earnings per share	$0.34	$0.33	$0.98	$0.78

See Notes to Unaudited Condensed Consolidated Financial Statements

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Live Oak Bancshares, Inc.
Condensed Consolidated Statements of Comprehensive Income
For the three and nine months ended September 30, 2018 and 2017 (unaudited)
(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$14,252	$12,862	$40,958	$28,769
Other comprehensive (loss) income before tax:				
Net unrealized (loss) gain on investment securities arising during the period	(2,094)	(168)	(7,014)	52
Reclassification adjustment for (gain) loss on sale of securities available-for-sale included in net income	—	—	—	—
Other comprehensive (loss) income before tax	(2,094)	(168)	(7,014)	52
Income tax benefit (expense)	502	65	1,683	(20)
Other comprehensive (loss) income, net of tax	(1,592)	(103)	(5,331)	32
Total comprehensive income	$12,660	$12,759	$35,627	$28,801

See Notes to Unaudited Condensed Consolidated Financial Statements

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Live Oak Bancshares, Inc.
Condensed Consolidated Statements of Changes in Shareholders' Equity
For the nine months ended September 30, 2018 and 2017 (unaudited)
(Dollars in thousands)

	Common stock Shares Class A	Class B	Amount	Retained earnings	Accumulated other comprehensive loss	Total equity
Balance at December 31, 2016	29,530,072	4,723,530	$199,981	$23,518	$ (652)	$222,847
Net income	—	—	—	28,769	—	28,769
Other comprehensive income	—	—	—	—	32	32
Issuance of restricted stock	306,902	—	—	—	—	—
Withholding cash issued in lieu of restricted stock issuance	—	—	(4,891)	—	—	(4,891)
Employee stock purchase program	22,634	—	445	—	—	445
Stock option exercises	76,285	—	602	—	—	602
Stock option based compensation expense	—	—	1,496	—	—	1,496
Restricted stock expense	—	—	4,210	—	—	4,210
Stock issued in acquisition of Reltco, Inc.	27,724	—	565	—	—	565
Non-voting common stock converted to voting common stock-private sale	80,000	(80,000)	—	—	—	—
Issuance of common stock in connection with secondary offering, net of issue costs	5,175,000	—	113,096	—	—	113,096
Cash dividends ($0.07 per share)	—	—	—	(2,580)	—	(2,580)
Balance at September 30, 2017	35,218,617	4,643,530	$315,504	$49,707	$ (620)	$364,591
Balance at December 31, 2017	35,252,053	4,643,530	$317,725	$120,241	$ (1,033)	$436,933
Net income	—	—	—	40,958	—	40,958
Other comprehensive loss	—	—	—	—	(5,331)	(5,331)
Issuance of restricted stock	59,162	—	—	—	—	—
Withholding cash issued in lieu of restricted stock issuance	—	—	(708)	—	—	(708)
Employee stock purchase program	14,339	—	342	—	—	342
Stock option exercises	171,333	—	1,587	—	—	1,587
Stock option based compensation expense	—	—	1,310	—	—	1,310
Restricted stock expense	—	—	5,743	—	—	5,743
Reclassification of accumulated other comprehensive income due to tax rate change	—	—	—	244	(244)	—
Cash dividends ($0.09 per share)	—	—	—	(3,604)	—	(3,604)
Balance at September 30, 2018	35,496,887	4,643,530	$325,999	$157,839	$ (6,608)	$477,230

See Notes to Unaudited Condensed Consolidated Financial Statements

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Live Oak Bancshares, Inc.
Condensed Consolidated Statements of Cash Flows
For the nine months ended September 30, 2018 and 2017 (unaudited)
(Dollars in thousands)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities		
Net income	$40,958	$28,769
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	12,009	7,020
Net provision for loan and lease losses	6,236	5,481
Amortization of premium on securities, net of accretion	576	355
Amortization of discount on unguaranteed loans, net	5,282	1,263
Impairment expense on goodwill and other intangibles, net	2,680	—
Deferred tax (benefit) expense	(2,392)	413
Originations of loans held for sale	(826,478)	(884,741)
Proceeds from sales of loans held for sale	966,076	648,300
Net gains on sale of loans held for sale	(69,483)	(55,276)
Net loss on sale of foreclosed assets	19	30
Net increase (decrease) in servicing assets	3,037	(1,398)
Net loss on disposal of premises and equipment	37	213
Stock option based compensation expense	1,310	1,496
Restricted stock expense	5,743	4,210
Stock based compensation expense excess tax benefits	110	1,073
Business combination contingent consideration fair value adjustment	(260)	350
Changes in assets and liabilities:		
Other assets	(4,158)	(17,661)
Other liabilities	2,665	3,875
Net cash provided (used) by operating activities	143,967	(256,228)
Cash flows from investing activities		
Purchases of securities available-for-sale	(327,422)	(13,009)
Proceeds from sales, maturities, calls, and principal paydowns of securities available-for-sale	36,813	7,187
Proceeds from sale/collection of foreclosed assets	392	50
Business combination, net of cash acquired	—	(7,696)
Sale of title insurance business, net of cash sold	(209)	—
Maturities of certificates of deposit with other banks	2,250	4,000
Loan and lease originations and principal collections, net	(332,115)	(273,501)
Proceeds from sale of premises and equipment	865 Portion	

Location of Gain
or (Loss)
Reclassified from
OCI into
Income - Effective
Portion

Gain or (Loss)
Reclassified
from OCI into
Income - Effective
Portion

Location of
Gain or (Loss)
Recognized -
Ineffective
Portion and
Amount
Excluded from
Effectiveness
Testing

Amount of
Gain or (Loss)
Recognized -
Ineffective
Portion and
Amount
Excluded from
Effectiveness
Testing

Three Months Ended
March 31,

Three Months Ended
March 31,

Three Months Ended
March 31,

2018

2017

2018

2017

2018

2017
Foreign currency exchange contracts

$
(107
)

$
589

Salaries and
employee
benefits

$
549

$
175

Other (expense)
income

$
—

$
—

Foreign currency exchange contracts

—

80

General and
administrative
expenses

—

14

Other (expense)
income

—

—

Interest rate swap agreements

9

5

Interest expense

—

77

Other (expense)
income

—

—

Derivatives Not Designated as Hedging Instruments

The Company enters into currency exchange forward contracts to reduce the effects of currency exchange rate fluctuations between the British Pound and Euro. These derivative contracts generally mature withinone to three months and are not designated as hedge instruments for accounting purposes. The Company continues to monitor the level of exposure of the foreign currency exchange risk and may enter into additional short-term forward contracts on an ongoing basis. The gains or losses on these derivative contracts are recognized in other income or expense based on the changes in fair value. The Company also holds two interest rate cap contracts with an aggregate notional amount of £300.0 million (approximately $421.6 million) that are used to manage its risk related to interest rate fluctuations. The Company does not apply hedge accounting on the interest rate cap contracts.

The following table summarizes the effects of derivatives in cash flow hedging relationships not designated as hedging instruments on the Company's condensed consolidated statements of operations for the three months ended March 31, 2018 and 2017 (in thousands):

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in income on	Amount of Gain or (Loss) Recognized in Income on Derivative

	Derivative	Three Months Ended March 31, 2018	2017
Foreign currency exchange contracts	Other income (expense)	$ (766)	$ (252)
Interest rate cap contracts	Interest expense	(88)	—
Interest rate swap agreements	Interest expense	—	77

Note 5: Investment in Receivable Portfolios, Net

In accordance with the authoritative guidance for loans and debt securities acquired with deteriorated credit quality, discrete receivable portfolio purchases during the same fiscal quarter are aggregated into pools based on common risk characteristics. Common risk characteristics include risk ratings (e.g. FICO or similar scores), financial asset type, collateral type, size, interest rate, date of origination, term, and geographic location. The Company's static pools are typically grouped into credit card, purchased consumer bankruptcy, and mortgage portfolios. The Company further groups these static pools by geographic region or location. Portfolios acquired in business combinations are also grouped into these pools. During any fiscal quarter in which the Company has an acquisition of an entity that has portfolio, the entire historical portfolio of the acquired company is aggregated into the pool groups for that quarter, based on common characteristics, resulting in pools for that quarter that may consist of several different vintages of portfolio. Once a static pool is established, the portfolios are permanently assigned to the pool. The discount (i.e., the difference between the cost of each static pool and the related aggregate contractual

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receivable balance) is not recorded because the Company expects to collect a relatively small percentage of each static pool's contractual receivable balance. As a result, receivable portfolios are recorded at cost at the time of acquisition. The purchase cost of the portfolios includes certain fees paid to third parties incurred in connection with the direct acquisition of the receivable portfolios.

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

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

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

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

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

	Accretable Yield	Estimate of Zero Basis Cash Flows	Total
Balance at December 31, 2017	$3,695,069	$369,632	$4,064,701
Revenue from receivable portfolios	(249,821)	(31,188)	(281,009)
Allowance reversals on receivable portfolios, net	(8,082)	(1,729)	(9,811)
Reductions on existing portfolios, net	(24,945)	(39,529)	(64,474)
Additions for current purchases, net	285,172	—	285,172
Effect of foreign currency translation	57,577	643	58,220
Balance at March 31, 2018	$3,754,970	$297,829	$4,052,799

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	Accretable Yield	Estimate of Zero Basis Cash Flows	Total
Balance at December 31, 2016	$3,092,004	$365,504	$3,457,508
Revenue from receivable portfolios	(211,105)	(38,733)	(249,838)
Allowance reversals on receivable portfolios, net	(613)	(1,519)	(2,132)
(Reductions) additions on existing portfolios, net	(90,138)	57,446	(32,692)
Additions for current purchases, net	200,728	—	200,728
Effect of foreign currency translation	38,712	467	39,179
Balance at March 31, 2017	$3,029,588	$383,165	$3,412,753

During the three months ended March 31, 2018, the Company purchased receivable portfolios with a face value of $1.8 billion for $276.8 million, or a purchase cost of 15.4% of face value. The estimated future collections at acquisition for all portfolios purchased during the three months ended March 31, 2018 amounted to $556.2 million. During the three months ended March 31, 2017, the Company purchased receivable portfolios with a face value of $1.7 billion for $218.7 million, or a purchase cost of 13.2% of face value. The estimated future collections at acquisition for all portfolios purchased during the three months ended March 31, 2017 amounted to $419.4 million. All collections realized after the net book value of a portfolio has been fully recovered ("Zero Basis Portfolios") are recorded as revenue ("Zero Basis Revenue"). During the three months ended March 31, 2018 and 2017, Zero Basis Revenue was approximately $31.2 million and $38.7 million, respectively. During the three months ended March 31, 2018 and 2017, allowance reversals on Zero Basis Portfolios were $1.7 million and $1.5 million, respectively.

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

	Three Months Ended March 31, 2018			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	$2,879,170	$ 11,443	$ —	$2,890,613
Purchases of receivable portfolios	276,762	—	—	276,762
Disposals or transfers to held for sale	(3,072)	—	—	(3,072)
Gross collections(1)	(455,143)	(1,171)	(32,788)	(489,102)
Put-backs and Recalls(2)	(3,691)	—	(129)	(3,820)
Foreign currency adjustments	61,590	350	—	61,940
Revenue recognized	249,821	—	31,188	281,009
Portfolio allowance reversals, net	8,082	—	1,729	9,811
Balance, end of period	$3,013,519	$ 10,622	$ —	$3,024,141
Revenue as a percentage of collections(3)	54.9 %	0.0 %	95.1 %	57.5 %

	Three Months Ended March 31, 2017			
	Accrual Basis Portfolios	Cost Recovery Portfolios	Zero Basis Portfolios	Total
Balance, beginning of period	$2,368,366	$ 14,443	$ —	$2,382,809
Purchases of receivable portfolios	218,727	—	—	218,727
Disposals or transfers to held for sale	(4,771)	—	—	(4,771)
Gross collections(1)	(400,004)	(640)	(40,219)	(440,863)
Put-backs and Recalls(2)	(1,757)	—	(33)	(1,790)
Foreign currency adjustments	30,020	(84)	—	29,936
Revenue recognized	211,105	—	38,733	249,838
Portfolio allowance reversals, net	613	—	1,519	2,132
Balance, end of period	$2,422,299	$ 13,719	$ —	$2,436,018
Revenue as a percentage of collections(3)	52.8 %	0.0 %	96.3 %	56.7 %

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

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

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

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

	Valuation Allowance Three Months Ended March 31,	
	2018	2017
Balance at beginning of period	$102,576	$137,037
Provision for portfolio allowances	940	—
Reversal of prior allowances	(10,751)	(2,132)
Effect of foreign currency translation	1,552	1,420
Balance at end of period	$94,317	$136,325

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Note 6: Deferred Court Costs, Net

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

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

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

	March 31, 2018	December 31, 2017
Court costs advanced	$774,091	$ 743,584
Court costs recovered	(310,014)	(299,606)
Court costs reserve	(378,190)	(364,015)
Deferred court costs	$85,887	$ 79,963

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

	Court Cost Reserve Three Months Ended March 31,	
	2018	2017
Balance at beginning of period	$(364,015)	$(327,926)
Provision for court costs	(25,067)	(18,005)
Net down of reserve after deferral period	12,952	12,024
Effect of foreign currency translation	(2,060)	(732)
Balance at end of period	$(378,190)	$(334,639)

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Note 7: Other Assets

Other assets consist of the following (in thousands):

	March 31, 2018	December 31, 2017
Identifiable intangible assets, net	$75,620	$ 75,736
Prepaid expenses	29,472	27,606
Prepaid income taxes	27,962	27,917
Service fee receivables	25,998	25,609
Assets held for sale	20,117	18,741
Other financial receivables	16,861	18,997
Deferred tax assets	16,231	18,773
Derivative instruments	5,240	5,834
Security deposits	3,329	3,451
Funds held in escrow	—	28,199
Other	56,136	51,865
Total	$276,966	$ 302,728

Note 8: Debt, Net

The Company is in compliance with all covenants under its financing arrangements as of March 31, 2018. The components of the Company's consolidated debt and capital lease obligations were as follows (in thousands):

	March 31, 2018	December 31, 2017
Encore revolving credit facility	$363,000	$328,961
Encore term loan facility	203,670	181,687
Encore senior secured notes	325,000	326,029
Encore convertible notes	483,500	483,500
Less: debt discount	(30,291)	(32,720)
Cabot senior secured notes	1,260,399	1,216,485
Less: debt discount	(2,120)	(1,927)
Cabot senior revolving credit facility	219,914	179,008
Cabot securitisation senior facility	407,508	391,790
Preferred equity certificates	271,284	253,324
Other credit facilities	68,319	68,001
Other	76,345	92,792
Capital lease obligations	5,058	6,069
	3,651,586	3,492,999
Less: debt issuance costs, net of amortization	(44,485)	(46,123)
Total	$3,607,101	$3,446,876

Encore Revolving Credit Facility and Term Loan Facility

The Company has a revolving credit facility and term loan facility pursuant to a Third Amended and Restated Credit Agreement dated December 20, 2016 (as amended, the "Restated Credit Agreement"). The Restated Credit Agreement includes a revolving credit facility of $794.6 million (the "Revolving Credit Facility"), a term loan facility of $206.7 million (the "Term Loan Facility", and together with the Revolving Credit Facility, the "Senior Secured Credit Facilities"), and an accordion feature that allows the Company to increase the Senior Secured Credit Facilities by an additional $250.0 million (approximately $150.3 million of which has been exercised).

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Provisions of the Restated Credit Agreement as of March 31, 2018 include, but are not limited to:

- Revolving Credit Facility commitments of (1) $626.0 million that expire in December 2021 and (2) $168.6 million that expire in February 2019, in each case with interest at a floating rate equal to, at the Company's option, either: (a) reserve adjusted London Interbank Offered Rate ("LIBOR"), plus a spread that ranges from 250 to 300 basis points depending on the cash flow leverage ratio of Encore and its restricted subsidiaries; or (b) alternate base rate, plus a spread that ranges from 150 to 200 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries. "Alternate base rate," as defined in the Restated Credit Agreement, means the highest of (i) the per annum rate which the administrative agent publicly announces from time to time as its prime lending rate, (ii) the federal funds effective rate from time to time, plus 0.5% per annum, (iii) reserved adjusted LIBOR determined on a daily basis for a one month interest period, plus 1.0% per annum and (iv) zero;
- A $190.8 million term loan maturing in December 2021, with interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted LIBOR, plus a spread that ranges from 250 to 300 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries; or (2) alternate base rate, plus a spread that ranges from 150 to 200 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries. Principal amortizes $7.4 million in 2018 and $14.8 million in each of 2019 and 2020 with the remaining principal due in 2021;
- A $15.9 million term loan maturing in February 2019, with interest at a floating rate equal to, at the Company's option, either: (1) reserve adjusted LIBOR, plus a spread that ranges from 250 to 300 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries; or (2) alternate base rate, plus a spread that ranges from 150 to 200 basis points, depending on the cash flow leverage ratio of Encore and its restricted subsidiaries. Principal amortizes $1.6 million in 2018 with the remaining principal due in 2019;
- A borrowing base under the Revolving Credit Facility equal to 35% of all eligible non-bankruptcy estimated remaining collections plus 55% of eligible estimated remaining collections for consumer receivables subject to bankruptcy;
- A maximum cash flow leverage ratio permitted of 3.00:1.00;
- A maximum cash flow first-lien leverage ratio of 2.00:1.00;
- A minimum interest coverage ratio of 1.75:1.00;
- The allowance of indebtedness in the form of senior secured notes not to exceed $350.0 million;
- The allowance of additional unsecured or subordinated indebtedness not to exceed $1.1 billion, including junior lien indebtedness not to exceed $400.0 million;
- Restrictions and covenants, which limit the payment of dividends and the incurrence of additional indebtedness and liens, among other limitations;
- Repurchases of up to $150.0 million of Encore's common stock after July 9, 2015, subject to compliance with certain covenants and available borrowing capacity;
- A change of control definition, that excludes acquisitions of stock by Red Mountain Capital Partners LLC, JCF FPK I, LP and their respective affiliates of up to 50% of the outstanding shares of Encore's voting stock;
- Events of default which, upon occurrence, may permit the lenders to terminate the facility and declare all amounts outstanding to be immediately due and payable;
- A pre-approved acquisition limit of $225.0 million per fiscal year;
- A basket to allow for investments not to exceed the greater of (1) 200% of the consolidated net worth of Encore and its restricted subsidiaries; and (2) an unlimited amount such that after giving effect to the making of any investment, the cash flow leverage ratio is less than 1.25:1:00;
- A basket to allow for investments in persons organized under the laws of Canada in the amount of $50.0 million;
- A requirement that Encore and its restricted subsidiaries, for the four-month period ending February 2019, have sufficient cash or availability under the Revolving Credit Facility (excluding availability under revolving

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commitments expiring in February 2019) to satisfy any amounts due under the revolving commitments that expire in February 2019 and the sub-tranche of the Term Loan Facility that expires in February 2019;

- Collateralization by all assets of the Company, other than the assets of certain foreign subsidiaries and all unrestricted subsidiaries as defined in the Restated Credit Agreement.

At March 31, 2018, the outstanding balance under the Revolving Credit Facility was $363.0 million, which bore a weighted average interest rate of 4.62% and 3.79% for the three months ended March 31, 2018 and 2017, respectively. Available capacity under the Revolving Credit Facility, after taking into account borrowing base and applicable debt covenants, was $237.5 million as of March 31, 2018, not including the $99.7 million additional capacity provided by the facility's remaining accordion feature. At March 31, 2018, the outstanding balance under the Term Loan Facility was $203.7 million.

Encore Senior Secured Notes

In August 2017, Encore entered into $325.0 million in senior secured notes with a group of insurance companies (the "Senior Secured Notes"). The Senior Secured Notes bear an annual interest rate of 5.625%, mature in 2024 and beginning in November 2019 will require quarterly principal payments of $16.3 million. As of March 31, 2018, $325.0 million of the Senior Secured Notes remained outstanding.

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

The covenants and material terms in the purchase agreement for the Senior Secured Notes are substantially similar to those in the Restated Credit Agreement. The holders of the Senior Secured Notes and the administrative agent for the lenders of the Restated Credit Agreement have an intercreditor agreement related to their pro rata rights to the collateral, actionable default, powers and duties and remedies, among other topics.

Encore Convertible Notes

In June and July 2013, Encore sold $172.5 million aggregate principal amount of 3.0% 2020 Convertible Notes that mature on July 1, 2020 in private placement transactions (the "2020 Convertible Notes"). In March 2014, Encore sold $161.0 million aggregate principal amount of 2.875% 2021 Convertible Notes that mature on March 15, 2021 in private placement transactions (the "2021 Convertible Notes"). In March 2017, Encore sold $150.0 million aggregate principal amount of 3.25% 2022 Convertible Senior Notes that mature on March 15, 2022 in private placement transactions (the "2022 Convertible Notes" and together with the 2020 Convertible Notes and the 2021 Convertible Notes, the "Convertible Notes"). The interest on the Convertible Notes is payable semi-annually.

Prior to the close of business on the business day immediately preceding their respective conversion date (listed below), holders may convert their Convertible Notes under certain circumstances set forth in the applicable Convertible Notes indentures. On or after their respective conversion dates until the close of business on the scheduled trading day immediately preceding their respective maturity date, holders may convert their Convertible Notes at any time. Certain key terms related to the convertible features for each of the Convertible Notes as of March 31, 2018 are listed below.

	2020 Convertible Notes	2021 Convertible Notes	2022 Convertible Notes
Initial conversion price	$ 45.72	$ 59.39	$ 45.57
Closing stock price at date of issuance	$ 33.35	$ 47.51	$ 35.05

Closing stock price date	June 24, 2013	March 5, 2014	February 27, 2017
Conversion rate (shares per $1,000 principal amount)	21.8718	16.8386	21.9467
Conversion date	January 1, 2020	September 15, 2020	September 15, 2021

In the event of conversion, holders of the Company's 2020 Convertible Notes, 2021 Convertible Notes, and 2022 Convertible Notes will receive cash, shares of the Company's common stock or a combination of cash and shares of the

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

Authoritative guidance requires that issuers of convertible debt instruments which, upon conversion, may be settled fully or partially in cash, must separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Additionally, debt issuance costs are required to be allocated in proportion to the allocation of the liability and equity components and accounted for as debt issuance costs and equity issuance costs, respectively.

The debt and equity components, the issuance costs related to the equity component, the stated interest rate, and the effective interest rate for each of the Convertible Notes are listed below (in thousands, except percentages):

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

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

	March 31, 2018	December 31, 2017
Liability component—principal amount	$483,500	$ 483,500
Unamortized debt discount	(30,291)	(32,720)
Liability component—net carrying amount	$453,209	$ 450,780
Equity component	$62,696	$ 62,696

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

	Three Months Ended March 31, 2018	2017
Interest expense—stated coupon rate	$3,642	$3,524
Interest expense—amortization of debt discount	2,428	2,486
Total interest expense—convertible notes	$6,070	$6,010

Convertible Notes Hedge Transactions

In order to reduce the risk related to the potential dilution and/or the potential cash payments the Company may be required to make in the event that the market price of the Company's common stock becomes greater than the conversion prices of the Convertible Notes, the Company maintains a hedge program that increases the effective conversion price for each of the 2020 Convertible Notes and 2021 Convertible Notes. The Company did not hedge the 2022 Convertible Notes. All of the hedge instruments related to the Convertible Notes have been determined to be indexed to the Company's own stock and meet the criteria for equity classification. In accordance with authoritative guidance, the Company recorded the cost of the hedge instruments as a reduction in additional paid-in capital, and will not recognize subsequent changes in fair value of these financial instruments in its consolidated financial statements.

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

	2020 Convertible Notes	2021 Convertible Notes
Cost of the hedge transaction(s)	$ 18,113	$ 19,545
Initial conversion price	$ 45.72	$ 59.39
Effective conversion price	$ 61.55	$ 83.14

Cabot Senior Secured Notes

On August 2, 2013, Cabot Financial issued £100.0 million (approximately $151.7 million) in aggregate principal amount of 8.375% Senior Secured Notes due 2020 (the "Cabot 2020 Notes"). Interest on the Cabot 2020 Notes is payable semi-annually, in arrears, on February 1 and August 1 of each year.

On March 27, 2014, Cabot Financial issued £175.0 million (approximately $291.8 million) in aggregate principal amount of 6.500% Senior Secured Notes due 2021 (the "Cabot 2021 Notes"). Interest on the Cabot 2021 Notes is payable semi-annually, in arrears, on April 1 and October 1 of each year.

On October 6, 2016, Cabot Financial issued £350.0 million (approximately $442.6 million) in aggregate principal amount of 7.500% Senior Secured Notes due 2023 (the "Cabot 2023 Notes" and together with the Cabot 2020 Notes and the Cabot 2021 Notes, the "Cabot Notes"). Interest on the Cabot 2023 Notes is payable semi-annually, in arrears, on April 1 and October 1 of each year. The Cabot 2023 Notes were issued at a price equal to 100% of their face value. The proceeds from the offering were used to (1) redeem in full the Cabot 2019 Notes plus a call premium of £13.7 million (approximately $17.4 million), (2) partially repay amounts outstanding under Cabot's revolving credit facility, (3) pay accrued interest on the Cabot 2019 Notes, and (4) pay fees and expenses in relation to the offering of the Cabot 2023 Notes.

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

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

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

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

	Three Months Ended March 31,	
	2018	2017
Interest expense—stated coupon rate	$21,600	$23,982
Interest income—accretion of debt premium	—	(1,016)
Interest expense—amortization of debt discount	(116)	110
Total interest expense—Cabot senior secured notes	$21,484	$23,076

At March 31, 2018, the outstanding balance on the Cabot senior secured notes was $1.3 billion.

Cabot Senior Revolving Credit Facility

On December 12, 2017, Cabot Financial (UK) Limited ("Cabot Financial UK") entered into an amended and restated senior secured revolving credit facility agreement, which provides for a total committed facility of £295.0 million (approximately $395.2 million) (as amended and restated, the "Cabot Credit Facility"). The Cabot Credit Facility consists of a £245.0 million tranche that expires in September 2021 and a £50.0 million tranche that expires in March 2022, and includes the following key provisions:

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

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

At March 31, 2018, the outstanding borrowings under the Cabot Credit Facility were approximately $219.9 million. The weighted average interest rate was 3.75% and 3.51% for the three months ended March 31, 2018 and 2017, respectively.

Cabot Securitisation Senior Facility

Cabot Securitisation has entered into a senior facility agreement (the "Senior Facility Agreement") for a committed amount of £300.0 million, of which £290.0 million was drawn as of March 31, 2018. The Senior Facility Agreement has an initial availability period ending in September 2020 and an initial repayment date in September 2022. The obligations of Cabot Securitisation under the Senior Facility Agreement are secured by first ranking security interests over all of Cabot Securitisation's property, assets and rights (including receivables purchased from Cabot Financial UK from time to time), the book value of which was approximately £308.1 million (approximately $432.9 million) as of March 31, 2018. Funds drawn under the Senior Facility Agreement will bear interest at a rate per annum equal to LIBOR plus a margin of 2.85%.

At March 31, 2018, the outstanding borrowings under the Cabot Securitisation Senior Facility were approximately $407.5 million. The weighted average interest rate was 3.35% for the three months ended March 31, 2018.

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Preferred Equity Certificates

On July 1, 2013, the Company, through its wholly owned subsidiary Encore Europe Holdings, S.à r.l. (“Encore Europe”), completed the acquisition of Cabot (the “Cabot Acquisition”) by acquiring 50.1% of the equity interest in Janus Holdings Luxembourg S.à r.l. (“Janus Holdings”). Encore Europe purchased from J.C. Flowers & Co. LLC (“J.C. Flowers”): (i) E Bridge preferred equity certificates issued by Janus Holdings, with a face value of £10,218,574 (approximately $15.5 million) (and any accrued interest thereof) (the “E Bridge PECs”), (ii) E preferred equity certificates issued by Janus Holdings with a face value of £96,729,661 (approximately $147.1 million) (and any accrued interest thereof) (the “E PECs”), (iii) 3,498,563 E shares of Janus Holdings (the “E Shares”), and (iv) 100 A shares of Cabot Holdings S.a r.l. (“Cabot Holdings”), the direct subsidiary of Janus Holdings, for an aggregate purchase price of approximately £115.1 million (approximately $175.0 million). The E Bridge PECs, E PECs, and E Shares represent 50.1% of all of the issued and outstanding equity and debt securities of Janus Holdings. The remaining 49.9% of Janus Holdings’ equity and debt securities are owned by J.C. Flowers and include: (a) J Bridge PECs with a face value of £10,177,781 (approximately $15.5 million), (b) J preferred equity certificates with a face value of £96,343,515 (approximately $146.5 million) (the “J PECs”), (c) 3,484,597 J shares of Janus Holdings (the “J Shares”), and (d) 100 A shares of Cabot Holdings.

All of the PECs accrue interest at 12% per annum. Since PECs are legal form debt, the J Bridge PECs, J PECs and any accrued interests thereof are classified as liabilities and are included in debt in the Company’s accompanying condensed consolidated statements of financial condition. In addition, certain other minority owners hold PECs at the Cabot Holdings level (the “Management PECs”). These PECs are also included in debt in the Company’s accompanying condensed consolidated statements of financial condition. The E Bridge PECs and E PECs held by the Company, and their related interest eliminate in consolidation and therefore are not included in debt in the Company’s condensed consolidated statements of financial condition. The J Bridge PECs, J PECs, and the Management PECs do not require the payment of cash interest expense as they have characteristics similar to equity with a preferred return. The ultimate payment of the accumulated interest would be satisfied only in connection with the disposition of the noncontrolling interest of J.C. Flowers and management.

On June 20, 2014, Encore Europe converted all of its E Bridge PECs into E Shares and E PECs, and J.C. Flowers converted all of its J Bridge PECs into J Shares and J PECs in proportion to the number of E Shares and E PECs, or J Shares and J PECs, as applicable, outstanding on the closing date of the Cabot Acquisition.

As of March 31, 2018, the outstanding balance of the PECs, including accrued interest, was approximately $271.3 million.

Capital Lease Obligations

The Company has capital lease obligations primarily for computer equipment. As of March 31, 2018, the Company’s combined obligations for capital leases were approximately $5.1 million. These capital lease obligations require monthly, quarterly or annual payments through 2022 and have implicit interest rates that range from 2.4% to approximately 5.9%.

Note 9: Variable Interest Entities

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

The Company’s VIEs include its subsidiary Janus Holdings and other immaterial special purpose entities that were created to purchase receivable portfolios in certain geographies.

Janus Holdings is the indirect parent company of Cabot. The Company has determined that Janus Holdings is a VIE and the Company is the primary beneficiary of the VIE. The key activities that affect Cabot’s economic performance include, but are not limited to, operational budgets and purchasing decisions. Through its control of the board of directors of Janus Holdings, the Company controls the key operating activities at Cabot.

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

The Company evaluates its relationships with its VIEs on an ongoing basis to ensure that it continues to be the primary beneficiary.

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Note 10: Income Taxes
Income tax expense on income from continuing operations was $9.5 million and $12.1 million during the three months ended March 31, 2018 and 2017, respectively.
On December 22, 2017, the U.S. Tax Cuts and Jobs Act (the “Tax Reform Act”) was signed into law by President Trump. The Tax Reform Act significantly revised the U.S. corporate income tax regime by, among other things, lowering the U.S. corporate tax rate from a top rate of 35% to a flat rate of 21% effective January 1, 2018, implementing elements of a territorial tax system and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. The decrease in the Company’s income tax expense for the three months ended March 31, 2018 as compared to the same period in 2017 was primarily due to the decrease in the U.S. corporate tax rate as a result of the Tax Reform Act.
Due to the complexities involved in accounting for the Tax Reform Act, Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”) allowed the Company to record provisional amounts in earnings for the year ended December 31, 2017. SAB 118 provides that where reasonable estimates can be made, the provisional accounting should be based on such estimates. During the three months ended March 31, 2018, there were no changes made to the provisional amounts recognized in 2017.
The Tax Reform Act subjects U.S. shareholders to a tax on global intangible low-taxed income (“GILTI”) earned by certain foreign subsidiaries. Under U.S. GAAP, the Company is allowed to make an accounting policy choice of either (1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred (the “period cost method”) or (2) factoring such amounts into the Company’s measurement of its deferred taxes (the “deferred method”). The Company has not yet adopted an accounting policy with respect to GILTI at March 31, 2018. The Company has reasonably estimated provisional amounts related to GILTI, based on current year operations only, and has included such amounts in its financial statements.
The Company will continue to analyze the effects of the Tax Reform Act, including the effects of GILTI, and additional impacts, if any. The impact of the Tax Reform Act may differ from the Company’s estimates, possibly materially, during the one-year measurement period due to, among other things, further refinement of the Company’s calculations, changes in interpretations and assumptions the Company has made, guidance that may be issued and actions the Company may take as a result of the Tax Reform Act.
The effective tax rates for the respective periods are shown below:

	Three Months Ended March 31,	
	2018	2017
Federal provision	21.0 %	35.0%
State provision	1.4 %	3.3 %
International provision[1]	7.0 %	4.3 %
Permanent items	0.4 %	0.8 %
Other[2]	(1.3)%	0.9 %
Effective rate	28.5 %	44.3%

(1) Relates primarily to the lower tax rates attributable to international operations, and the impact of valuation allowances recorded on foreign loss jurisdictions.
(2) Includes impact of discrete items.

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

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

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The Company had gross unrecognized tax benefits, inclusive of penalties and interest, of $22.2 million at March 31, 2018. These unrecognized tax benefits, if recognized, would result in a net tax benefit of $9.9 million as of March 31, 2018. The gross unrecognized tax benefits did not change from December 31, 2017.

Of the $217.1 million of cash and cash equivalents as of March 31, 2018, $187.8 million was held outside of the United States. Following the enactment of the Tax Reform Act and the associated transition tax, in general, repatriation of cash to the United States can be completed with no incremental U.S. tax. However, repatriation of cash could subject the Company to non-U.S. jurisdictional taxes on distributions. The Company maintains non-U.S. funds in its foreign operations to (i) provide adequate working capital, (ii) satisfy various regulatory requirements, and (iii) take advantage of business expansion opportunities as they arise. The non-U.S. jurisdictional taxes applicable to foreign earnings are not readily determinable or practicable. The Company continues to evaluate the impact of the Tax Reform Act on its election to indefinitely reinvest certain of its non-U.S. earnings. As of March 31, 2018, management believes that it has sufficient liquidity to satisfy its cash needs, including its cash needs in the United States.

Note 11: Commitments and Contingencies

Litigation and Regulatory

The Company is involved in disputes, legal actions, regulatory investigations, inquiries, and other actions from time to time in the ordinary course of business. The Company, along with others in its industry, is routinely subject to legal actions based on the Fair Debt Collection Practices Act (“FDCPA”), comparable state statutes, the Telephone Consumer Protection Act (“TCPA”), state and federal unfair competition statutes, and common law causes of action. The violations of law investigated or alleged in these actions often include claims that the Company lacks specified licenses to conduct its business, attempts to collect debts on which the statute of limitations has run, has made inaccurate or unsupported assertions of fact in support of its collection actions and/or has acted improperly in connection with its efforts to contact consumers. Such litigation and regulatory actions could involve potential compensatory or punitive damage claims, fines, sanctions, injunctive relief, or changes in business practices. Many continue on for some length of time and involve substantial investigation, litigation, negotiation, and other expense and effort before a result is achieved, and during the process the Company often cannot determine the substance or timing of any eventual outcome.

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

In certain legal proceedings, the Company may have recourse to insurance or third party contractual indemnities to cover all or portions of its litigation expenses, judgments, or settlements. In accordance with authoritative guidance, the Company records loss contingencies in its financial statements only for matters in which losses are probable and can be reasonably estimated. Where a range of loss can be reasonably estimated with no best estimate in the range, the Company records the minimum estimated liability. The Company continuously assesses the potential liability related to its pending litigation and regulatory matters and revises its estimates when additional information becomes available. As of March 31, 2018, other than the reserves related to the Consumer Finance Protection Bureau (“CFPB”) Consent Order and ancillary state regulatory matters, the Company has no material reserves for legal matters. Additionally, based on the current status of litigation and regulatory matters, either the estimate of exposure is immaterial to the Company’s financial statements or an estimate cannot yet be determined. The Company’s legal costs are recorded to expense as incurred.

Purchase Commitments

In the normal course of business, the Company enters into forward flow purchase agreements and other purchase commitment agreements. As of March 31, 2018, the Company has entered into agreements to purchase receivable portfolios with a face value of approximately $2.8 billion for a purchase price of approximately $469.7 million. Most purchase commitments do not extend past one year.

Note 12: Segment and Geographic Information

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

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The Company has operations in the United States, Europe and other foreign countries. The following table presents information about geographic areas in which the Company operates (in thousands):

	Three Months Ended March 31,	
	2018	2017
Revenues, adjusted by net allowances(1):		
United States	$171,944	$170,316
International		
Europe(2)	130,423	77,938
Other geographies	24,421	23,687
	154,844	101,625
Total	$326,788	$271,941

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(1) Revenues, adjusted by net allowances, are attributed to countries based on location of customer.

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

Note 13: Goodwill and Identifiable Intangible Assets

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

The annual goodwill testing date for the reporting units that are included in the portfolio purchasing and recovery reportable segment is October 1st. There have been no events or circumstances during the three months ended March 31, 2018 that have required the Company to perform an interim assessment of goodwill carried at these reporting units. Management continues to evaluate and monitor all key factors impacting the carrying value of the Company's recorded goodwill and long-lived assets. Adverse changes in the Company's actual or expected operating results, market capitalization, business climate, economic factors or other negative events that may be outside the control of management could result in a material non-cash impairment charge in the future.

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

	Total
Balance, December 31, 2017	$928,993
Goodwill adjustments	(2,212)
Effect of foreign currency translation	30,339
Balance, March 31, 2018	$957,120

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

	As of March 31, 2018			As of December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	$76,661	$ (8,973)	$67,688	$73,875	$ (6,800)	$67,075
Developed technologies	6,848	(5,825)	1,023	6,683	(5,411)	1,272
Trade name and other	14,782	(7,873)	6,909	14,413	(7,024)	7,389
Total intangible assets	$98,291	$ (22,671)	$75,620	$94,971	$ (19,235)	$75,736

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Note 14: Guarantee of Subsidiary Debt

Unless otherwise indicated in connection with a particular offering of debt securities, Encore will fully and unconditionally guarantee any debt securities issued by Encore Capital Europe Finance Limited (“Encore Finance”), a 100% owned finance subsidiary of Encore. Amounts related to Encore Finance are included in the consolidated financial statements of Encore issued subsequent to April 30, 2018, the date of the incorporation of Encore Finance.

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Note 15: Subsequent Events

On May 7, 2018, the Company entered into (i) a Securities Purchase Agreement (the “JCF SPA”) with JCF III Europe Holdings LP, JCF III Europe S.à r.l. (JCF III Europe Holdings LP and JCF III Europe S.à r.l. collectively referred to as “JCF Sellers”), Janus Holdings, and the other parties named therein, pursuant to which Encore will indirectly acquire from the JCF Sellers all of the equity interests owned by the JCF Sellers in Janus Holdings and Cabot Holdings (as defined below), resulting in Janus Holdings becoming a wholly owned subsidiary of Encore, and (ii) a Securities Purchase Agreement (the “Management SPA” and, together with the JCF SPA, the “Purchase Agreements”) with certain management shareholders of Cabot Holdings S.à r.l. Luxembourg (“Cabot Holdings,” and such holders, together with all other management holders that will sign a joinder to the Management SPA, the “Management Sellers”), pursuant to which Encore will indirectly acquire from the Management Sellers all of the equity interests in Cabot Holdings owned by the Management Sellers, resulting in Cabot Holdings becoming a wholly owned subsidiary of Encore.

The aggregate purchase price for the acquisition of the outstanding equity interests in Janus Holdings and Cabot Holdings not already owned by Encore is comprised of £175.5 million (approximately $238.2 million) and up to 4,999,947 shares of Encore’s common stock, par value $0.01 per share. The cash consideration portion of the purchase price is subject to adjustment in accordance with the terms of the applicable Purchase Agreement and the number of shares of Encore’s common stock may be reduced as a result of management holders owning 2,000 or less C Shares of Cabot Holdings electing to receive cash consideration only.

The closing of the transactions is expected to occur in the second or third quarter of 2018. The closing of the JCF SPA is subject to regulatory approvals and other customary closing conditions, and the closing of the Management SPA is subject to the closing of the JCF SPA and other customary closing conditions. Encore and the other parties to the respective Purchase Agreements made customary representations, warranties and covenants in the respective Purchase Agreements.

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

This Quarterly Report on Form 10-Q contains “forward-looking statements” relating to Encore Capital Group, Inc. (“Encore”) and its subsidiaries (which we may collectively refer to as the “Company,” “we,” “our” or “us”) within the meaning of the securities laws. The words “believe,” “expect,” “anticipate,” “estimate,” “project,” “intend,” “plan,” “will,” “may,” and s expressions often characterize forward-looking statements. These statements may include, but are not limited to, projections of collections, revenues, income or loss, estimates of capital expenditures, plans for future operations, products or services and financing needs or plans, as well as assumptions relating to these matters. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we caution that these expectations or predictions may not prove to be correct or we may not achieve the financial results, savings, or other benefits anticipated in the forward-looking statements. These forward-looking statements are necessarily estimates reflecting the best judgment of our senior management and involve a number of risks and uncertainties, some of which may be beyond our control or cannot be predicted or quantified, that could cause actual results to differ materially from those suggested by the forward-looking statements. Many factors including, but not limited to, those set forth in our Annual Report on Form 10-K under “Part I, Item 1A. Risk Factors,” could cause our actual results, performance, achievements, or industry results to be very different from the results, performance, achievements or industry results expressed or implied by these forward-looking statements. Our business, financial condition, or results of operations could also be materially and adversely affected by other factors besides those listed. Forward-looking statements speak only as of the date the statements were made. We do not undertake any obligation to update or revise any forward-looking statements to reflect new information or future events, or for any other reason, even if experience or future events make it clear that any expected results expressed or implied by these forward-looking statements will not be realized. In addition, it is generally our policy not to make any specific projections as to future earnings, and we do not endorse projections regarding future performance that may be made by third parties.

Our Business

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

United States

We are a market leader in portfolio purchasing and recovery in the United States, including Puerto Rico.

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Europe

Cabot Credit Management plc (together with its subsidiaries, “Cabot”), our largest international subsidiary, is one of the largest credit management services providers in Europe and is a market leader in the United Kingdom and Ireland. We control Cabot via our majority ownership interest in the indirect holding company of Cabot, Janus Holdings Luxembourg S.à r.l. (“Janus Holdings”).

In addition, we have certain subsidiaries that primarily focus on (a) consumer non-performing loans, including insolvencies (in particular, individual voluntary arrangements, or “IVAs”) in the United Kingdom and bank and non-bank receivables in Spain and (b) credit management services in Spain (collectively, “Grove”).

Latin America

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

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

Asia Pacific

Our subsidiary, Baycorp Holdings Pty Limited (together with its subsidiaries, “Baycorp”), specializes in the management of non-performing loans in Australia and New Zealand. In addition to purchasing defaulted receivables, Baycorp offers portfolio management services to banks for non-performing loans. We acquired a majority ownership interest in Baycorp in October 2015 and acquired the remaining minority equity ownership interest in Baycorp in January 2018.

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

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

Government Regulation

Our U.S. debt purchasing business and collection activities are subject to federal, state and municipal statutes, rules, regulations and ordinances that establish specific guidelines and procedures that debt purchasers and collectors must follow when collecting consumer accounts, including among others, specific guidelines and procedures for communicating with consumers and prohibitions on unfair, deceptive or abusive debt collection practices. Additionally, our international operations are affected by foreign statutes, rules and regulations regarding debt collection and debt purchase activities. These statutes, rules, regulations, ordinances, guidelines and procedures are modified from time to time by the relevant authorities charged with their administration, which could affect the way we conduct our business. See “Part I - Item 1 - Business - Government Regulation” contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 for additional detail.

Portfolio Purchasing and Recovery

United States

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

While seasonality does not have a material impact on our business, collections are generally strongest in our first calendar quarter, slower in the second and third calendar quarters, and slowest in the fourth calendar quarter.

Relatively higher collections in the first quarter could result in a lower cost-to-collect ratio compared to the other quarters, as our fixed costs are

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relatively constant and applied against a larger collection base. The seasonal impact on our business may also be influenced by our purchasing levels, the types of portfolios we purchase, and our operating strategies.

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

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

International

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

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

Purchases and Collections

Portfolio Pricing, Supply and Demand

United States

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

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

International

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

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The U.K. insolvency market as a whole has remained flat over the past twelve months, although we are seeing an increase in individual insolvencies driven by high unemployment rates. We expect that this trend will drive increased purchasing opportunities once large retail banks start to off-load their insolvency portfolios.
The Spanish debt market continues to be one of the largest in Europe with a significant amount of debt to be sold and serviced. In particular, we anticipate strong debt purchasing and servicing opportunities in the secured and small and medium enterprise asset classes given the backlog of non-performing debt that has accumulated in these sectors. Additionally, financial institutions continue to experience both market and regulatory pressure to dispose of non-performing loans which should further increase debt purchasing opportunities in Spain.
Although pricing has been elevated, we believe that as our European businesses increase in scale and expand to other markets, and with anticipated improvements in liquidation and improved efficiencies in collections, our margins will remain competitive. Additionally, Cabot's continuing investment in its litigation liquidation channel has enabled them to collect from consumers who have the ability to pay, but have so far been unwilling to do so. This enables Cabot to mitigate some of the impact of elevated pricing.
Purchases by Type and Geographic Location
The following table summarizes the types and geographic locations of consumer receivable portfolios we purchased during the periods presented (in thousands):

	Three Months Ended March 31,	
	2018	2017
United States:		
Credit card	$166,190	$112,726
Other	12,848	10,152
Subtotal	179,038	122,878
Europe:		
Credit card	68,397	85,113
Other	18,918	—
Subtotal	87,315	85,113
Other geographies:		
Credit card	10,409	10,000
Other	—	736
Subtotal	10,409	10,736
Total purchases	$276,762	$218,727

During the three months ended March 31, 2018, we invested $276.8 million to acquire consumer receivable portfolios, with face values aggregating $1.8 billion, for an average purchase price of 15.4% of face value. This is a $58.1 million, or 26.6%, increase in the amount invested, compared with the $218.7 million invested during the three months ended March 31, 2017, to acquire consumer receivable portfolios with face values aggregating $1.7 billion, for an average purchase price of 13.2% of face value.
In the United States, capital deployment increased for the three months ended March 31, 2018, as compared to the corresponding period in the prior year. The increase was primarily driven by continued growth in the supply of fresh portfolios. We have been successful in securing larger volume of fresh portfolios with improved expected returns.
In Europe, capital deployment for the three months ended March 31, 2018 increased as compared to the corresponding period in the prior year. The increase was primarily driven by the favorable impact from foreign currency translation, due to the weakening of the U.S. dollar against the British Pound and Euro.
The average purchase price, as a percentage of face value, varies from period to period depending on, among other factors, the quality of the accounts purchased and the length of time from charge-off to the time we purchase the portfolios.
Collections by Channel and Geographic Location

We currently utilize three channels for the collection of our receivables: collection sites, legal collections, and collection agencies. The collection sites channel consists of collections that result from our call centers, direct mail program and online

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

	Three Months Ended March 31,	
	2018	2017
United States:		
Collection sites	$153,967	$131,718
Legal collections	132,642	142,964
Collection agencies	12,358	12,793
Subtotal	298,967	287,475
Europe:		
Collection sites	82,011	75,818
Legal collections	31,380	29,266
Collection agencies	48,786	20,874
Subtotal	162,177	125,958
Other geographies:		
Collection sites	22,171	21,122
Legal collections	2,107	1,784
Collection agencies	3,680	4,524
Subtotal	27,958	27,430
Total collections	$489,102	$440,863

Gross collections increased by $48.2 million, or 10.9%, to $489.1 million during the three months ended March 31, 2018, from $440.9 million during the three months ended March 31, 2017.

The increase of collections in the United States was primarily due to the acquisition of portfolios with higher returns in recent periods and our continued effort in improving liquidation. The increase in collections in Europe was primarily the result of increased purchasing volume and implementing certain liquidation improvement initiatives and by favorable impact of foreign currency translation, which was primarily the result of the weakening of the U.S. dollar against the British Pound.

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Results of Operations

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

	Three Months Ended March 31,			
	2018		2017	
Revenues				
Revenue from receivable portfolios	$281,009	86.0 %	$249,838	91.9 %
Other revenues	35,968	11.0 %	19,971	7.3 %
Total revenues	316,977	97.0 %	269,809	99.2 %
Allowance reversals on receivable portfolios, net	9,811	3.0 %	2,132	0.8 %
Total revenues, adjusted by net allowances	326,788	100.0 %	271,941	100.0 %
Operating expenses				
Salaries and employee benefits	89,259	27.3 %	68,278	25.1 %
Cost of legal collections	53,855	16.5 %	47,957	17.6 %
Other operating expenses	33,748	10.3 %	26,360	9.7 %
Collection agency commissions	11,754	3.6 %	11,562	4.2 %
General and administrative expenses	39,284	12.0 %	33,318	12.3 %
Depreciation and amortization	10,436	3.2 %	8,625	3.2 %
Total operating expenses	238,336	72.9 %	196,100	72.1 %
Income from operations	88,452	27.1 %	75,841	27.9 %
Other (expense) income				
Interest expense	(57,462)	(17.6)%	(49,198)	(18.1)%
Other income	2,193	0.7 %	602	0.2 %
Total other expense	(55,269)	(16.9)%	(48,596)	(17.9)%
Income from continuing operations before income taxes	33,183	10.2 %	27,245	10.0 %
Provision for income taxes	(9,470)	(2.9)%	(12,067)	(4.4)%
Income from continuing operations	23,713	7.3 %	15,178	5.6 %
Loss from discontinued operations, net of tax	—	—	(199)	(0.1)%
Net income	23,713	7.3 %	14,979	5.5 %
Net (income) loss attributable to noncontrolling interest	(1,886)	(0.6)%	7,119	2.6 %
Net income attributable to Encore Capital Group, Inc. stockholders	$21,827	6.7 %	$22,098	8.1 %

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Results of Operations—Cabot

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

	Three Months Ended March 31, 2018			Three Months Ended March 31, 2017		
	Janus Holdings	Encore Europe[(1)]	Consolidated	Janus Holdings	Encore Europe[(1)]	Consolidated
Total revenues, adjusted by net allowances	$122,225	$—	$122,225	$70,306	$—	$70,306
Total operating expenses	(71,219)	—	(71,219)	(43,327)	—	(43,327)
Income from operations	51,006	—	51,006	26,979	—	26,979
Interest expense-non-PEC	(28,746)	—	(28,746)	(25,639)	—	(25,639)
PEC interest (expense) income	(15,141)	7,420	(7,721)	(12,039)	5,900	(6,139)
Other income (expense)	778	—	778	(352)	—	(352)
Income (loss) before income taxes	7,897	7,420	15,317	(11,051)	5,900	(5,151)
(Provision) benefit for income taxes	(4,779)	—	(4,779)	180	—	180
Net income (loss)	3,118	7,420	10,538	(10,871)	5,900	(4,971)
Net (income) loss attributable to noncontrolling interest	(704)	(1,205)	(1,909)	1,427	4,712	6,139
Net income (loss) attributable to Encore Capital Group, Inc. stockholders	$2,414	$6,215	$8,629	$(9,444)	$10,612	$1,168

(1) Includes only the results of operations related to Janus Holdings and therefore does not represent the complete financial performance of Encore Europe.

For all periods presented, Janus Holdings recognized all interest expense related to the outstanding preferred equity certificates (“PECs”) owed to Encore and other minority shareholders, while the interest income from PECs owed to Encore was recognized at Janus Holdings’ parent company, Encore Europe Holdings, S.à r.l. (“Encore Europe”), which is a wholly-owned subsidiary of Encore.

Comparison of Results of Operations

Revenues

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

Revenue from receivable portfolios consists of accretion revenue and zero basis revenue. Accretion revenue represents revenue derived from pools (quarterly groupings of purchased receivable portfolios) with a cost basis that has not been fully amortized. Revenue from pools with a remaining unamortized cost basis is accrued based on each pool’s effective interest rate applied to each pool’s remaining unamortized cost basis. The cost basis of each pool is increased by revenue earned and decreased by gross collections and portfolio allowances. The effective interest rate is the internal rate of return (“IRR”) derived from the timing and amounts of actual cash received and anticipated future cash flow projections for each pool. All collections realized after the net book value of a portfolio has been fully recovered, or Zero Basis Portfolios (“ZBA”), are recorded as revenue, or zero basis revenue. We account for our investment in receivable portfolios utilizing the interest method in accordance with the authoritative guidance for loans and debt securities acquired with deteriorated credit quality.

Other revenues consist primarily of fee-based income earned on accounts collected on behalf of others, primarily credit originators. Certain of the Company’s international subsidiaries earn fee-based income by providing portfolio management services to credit originators for non-performing loans.

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

Total revenues, adjusted by net allowances, were $326.8 million during the three months ended March 31, 2018, an increase of $54.8 million, or 20.2%, compared to total revenues, adjusted by net allowances of $271.9 million during the three months ended March 31, 2017.

Our operating results are impacted by foreign currency translation, which represents the effect of translating operating results where the functional currency is different than our U.S. dollar reporting currency. The strengthening of the U.S. dollar relative to other foreign currencies has an unfavorable impact on our international revenues, and the weakening of the U.S. dollar relative to other foreign currencies has a favorable impact on our international revenues. Our revenues were favorably impacted by foreign currency translation, primarily by the weakening of the U.S. dollar against the British Pound by 12.3% for the three months ended March 31, 2018 compared to the three months ended March 31, 2017.

Revenue from receivable portfolios was $281.0 million during the three months ended March 31, 2018, an increase of $31.2 million, or 12.5%, compared to $249.8 million during the three months ended March 31, 2017. The increase in portfolio revenue during the three months ended March 31, 2018 compared to the three months ended March 31, 2017 was due to recent purchases in Europe and by favorable impact of foreign currency translation, which was primarily the result of the weakening of the U.S. dollar against the British Pound.

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

	Three Months Ended March 31, 2018					As of March 31, 2018	
	Collections	Revenue[1]	Revenue Recognition Rate	Net Reversal (Portfolio Allowance)	Revenue % of Total Revenue	Unamortized Balances	Monthly IRR
United States:							
ZBA[2]	$29,919	$28,319	94.7 %	$ 1,729	10.1 %	$ —	—
2008	1,042	194	18.6 %	—	0.1 %	569	5.2 %
2009[3]	—	—	—	—	—	—	—
2010[3]	—	—	—	—	—	—	—
2011	3,601	3,493	97.0 %	—	1.2 %	4,477	25.0 %
2012	9,745	8,729	89.6 %	(723)	3.2 %	14,658	16.6 %
2013	28,557	22,787	79.8 %	—	8.1 %	42,896	10.1 %
2014	26,699	14,949	56.0 %	—	5.3 %	100,757	4.4 %
2015	36,950	16,136	43.7 %	—	5.7 %	181,772	2.1 %
2016	67,702	29,331	43.3 %	—	10.4 %	330,757	2.1 %
2017	86,211	41,971	48.7 %	—	14.9 %	449,697	2.7 %
2018	8,541	5,024	58.8 %	—	1.8 %	175,317	3.1 %
Subtotal	298,967	170,933	57.2 %	1,006	60.8 %	1,300,802	3.7 %
Europe:							
ZBA[2]	5	5	100.0 %	—	0.0 %	—	—
2013	36,129	25,462	70.5 %	2,766	9.2 %	274,318	3.2 %
2014	35,808	21,949	61.3 %	5,419	7.8 %	290,257	2.1 %
2015	24,605	13,613	55.3 %	462	4.8 %	230,083	2.0 %
2016	23,570	13,503	57.3 %	—	4.8 %	210,993	2.2 %
2017	40,874	15,279	37.4 %	—	5.4 %	439,643	1.4 %
2018	1,186	1,251					