PORTFOLIO RECOVERY ASSOCIATES INC
Form 10-K
February 28, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2007

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

For the transition period from __________ to __________

Commission File Number: 000-50058

Portfolio Recovery Associates, Inc.

(Exact name of registrant as specified in its charter)

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

Registrant s telephone number, including area code: (888) 772-7326

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $0.01 par value per share

(Title of Class)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES o NO þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. YES o NO þ

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 and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K. o

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2007 was $939,454,107 based on the $60.02 closing price as reported on the NASDAQ Global Stock Market.

The number of shares of the registrant s Common Stock outstanding as of February 14, 2008 was 15,163,056.

Documents incorporated by reference: Portions of the Proxy Statement to be filed by April 30, 2008 for our 2008 Annual Meeting of Stockholders are incorporated by reference into Items 11, 12 and 13 of Part III of this Form 10-K.

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Cautionary Statements Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995:

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

- our ability to purchase defaulted consumer receivables at appropriate prices;
- changes in the business practices of credit originators in terms of selling defaulted consumer receivables or outsourcing defaulted consumer receivables to third-party contingent fee collection agencies;
- changes in government regulations that affect our ability to collect sufficient amounts on our acquired or serviced receivables;
- changes in bankruptcy laws that could negatively affect our business;
- our ability to employ and retain qualified employees, especially collection personnel;
- changes in the credit or capital markets, which affect our ability to borrow money or raise capital to purchase or service defaulted consumer receivables;
- the degree and nature of our competition;
- our ability to comply with the provisions of the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated thereunder;
- our ability to secure sufficient levels of placements for our fee-for-service businesses;
- the sufficiency of our funds generated from operations, existing cash and available borrowings to finance our current operations; and
- the risk factors listed from time to time in our filings with the Securities and Exchange Commission (the SEC).

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

For a discussion of the risks, uncertainties and assumptions that could affect our future events, developments or results, you should carefully review the Risk Factors described beginning on page 17, as well as Business beginning on page 4 and Management s Discussion and Analysis of Financial Condition and Results of Operations beginning on page 29.

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

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

PART I

Item 1. Business.

General

We are a full-service provider of outsourced receivables management and related services. Our primary business is the purchase, collection and management of portfolios of defaulted consumer receivables. These are the unpaid obligations of individuals to credit originators, which include banks, credit unions, consumer and auto finance companies and retail merchants. We also provide a broad range of contingent and fee-based services, including collateral-location services for credit originators via PRA Location Services, LLC (IGS), fee-based collections through Anchor Receivables Management (ARM) and revenue administration, audit and debt discovery/recovery services for government entities through PRA Government Services, LLC (RDS). We believe that the strengths of our business are our sophisticated approach to portfolio pricing and servicing, our emphasis on developing and retaining our collection personnel, our sophisticated collections systems and procedures and our relationships with many of the largest consumer lenders in the United States. Our proven ability to service defaulted consumer receivables allows us to offer debt owners a complete outsourced solution to address their defaulted consumer receivables. The defaulted consumer receivables we collect are generally either purchased from sellers of defaulted consumer debt or are collected on behalf of debt owners on a commission fee basis. We intend to continue to build on our strengths and grow our business through the disciplined approach that has contributed to our success to date.

We use the following terminology throughout our reports: Cash Receipts refers to collections on our owned portfolios together with commission income and sales of finance receivables. Cash Collections refers to collections on our owned portfolios only, exclusive of commission income and sales of finance receivables. Amortization Rate refers to cash collections applied to principal as a percentage of total cash collections. Income Recognized on Finance Receivables refers to income derived from our owned debt portfolios and is shown net of valuation allowances. Cash Sales of Finance Receivables refers to the sales of our owned portfolios. Commissions refers to fee income generated from our wholly-owned contingent fee and fee-for-service subsidiaries.

We specialize in receivables that have been charged-off by the credit originator. Because the credit originator and/or other debt servicing companies have unsuccessfully attempted to collect these receivables, we are able to purchase them at a substantial discount to their face value. From our 1996 inception through December 31, 2007, we acquired 1,030 portfolios with a face value of $35.3 billion for $791.6 million, representing more than 16.7 million customer accounts. The success of our business depends on our ability to purchase portfolios of defaulted consumer receivables at appropriate valuations and to collect on those receivables effectively and efficiently. Since inception, we have been able to collect at an average rate of 2.5 to 3.0 times our purchase price for defaulted consumer receivables portfolios, as measured over a five to twelve year period, which has enabled us to generate increasing profits and positive operational cash flow.

We have achieved strong financial results since our formation, with cash collections growing from $10.9 million in 1998 to $262.2 million in 2007. Total revenue has grown from $6.8 million in 1998 to $220.7 million in 2007, a compound annual growth rate of 47%. Similarly, pro forma net income has grown from $402,000 in 1998 to net income of $48.2 million in 2007.

We were initially formed as Portfolio Recovery Associates, L.L.C., a Delaware limited liability company, on March 20, 1996. Prior to the formation of Portfolio Recovery Associates, Inc., members of our current management team played key roles in the development of a defaulted consumer receivables acquisition and divestiture operation for Household Recovery Services, a subsidiary of Household International, now owned by HSBC. In connection with our 2002 initial public offering (our IPO), all of the membership units of Portfolio Recovery Associates, L.L.C. were exchanged, simultaneously with the effectiveness of our registration statement, for a single class of the common stock of Portfolio Recovery Associates, Inc., a new Delaware corporation formed on August 7, 2002. Accordingly, the members of Portfolio Recovery Associates, L.L.C. became the common stockholders of Portfolio Recovery Associates, Inc., which became the parent company of Portfolio Recovery Associates, L.L.C. and its subsidiaries.

The Company maintains an Internet website at the following address: www.portfoliorecovery.com.

We make available on or through our website certain reports that we file with or furnish to the SEC in accordance with the Securities Exchange Act of 1934. These include our annual reports on Form 10-K, our quarterly reports on Form 10-Q and our current reports on Form 8-K. We make this information available on our website free of charge as soon as reasonably practicable after we electronically file the information with or furnish it to the SEC. The information that is filed with the SEC may be read or copied at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. In addition, information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at: www.sec.gov.

Reports filed with or furnished to the SEC are also available free of charge upon request by contacting our corporate office at:

Portfolio Recovery Associates, Inc.
Attn: Investor Relations
120 Corporate Boulevard, Suite 100
Norfolk, Virginia 23502

Competitive Strengths

Complete Outsourced Solution for Debt Owners

We offer debt owners a complete outsourced solution to address their defaulted consumer receivables. Depending on a debt owner s timing and needs, we can either purchase their defaulted consumer receivables, providing immediate cash, or service those receivables on their behalf for either a fee-for-service or a commission fee, based on a percentage of our collections. We can purchase or service receivables throughout the entire delinquency cycle, from receivables that have only been processed for collection internally by the debt owner to receivables that have been subject to multiple internal and external collection efforts. This flexibility helps us meet the needs of debt owners and allows us to become a trusted resource. Furthermore, our strength across multiple transaction and asset types provides the opportunity to cross-sell our services to debt owners, building on successful engagements. Through our RDS business, we have the ability to provide these services to local and state governments.

Disciplined and Proprietary Underwriting Process

One of the key components of our growth has been our ability to price portfolio acquisitions at levels that have generated profitable returns on investment. Since inception, we have been able to collect at an average rate of 2.5 to 3.0 times our purchase price for defaulted consumer receivables portfolios, as measured over a five to twelve year period, which has enabled us to generate increasing profits and operational cash flow. In order to price portfolios and forecast the targeted collection results for a portfolio, we use two separate internally developed statistical models and one externally developed model, which we may supplement with on-site due diligence and data obtained from the debt owner s collection process and loan files. One model analyzes the portfolio as one unit based on demographic comparisons, while the second model analyzes each account in a portfolio using variables in a regression analysis. As we collect on our portfolios, the results are input back into the models in an ongoing process which we believe increases their accuracy. Through December 31, 2007, we have acquired 1,030 portfolios with a face value of $35.3 billion.

Ability to Hire, Develop and Retain Productive Collectors

We place considerable focus on our ability to hire, develop and retain effective collectors who are key to our continued growth and profitability. Several large military bases and numerous telemarketing, customer service and reservation phone centers are located near our headquarters and regional offices in Virginia, providing access to a large pool of eligible personnel. The Hutchinson, Kansas, Las Vegas, Nevada, Birmingham, Alabama and Jackson, Tennessee areas also provide a sufficient potential workforce of eligible personnel. We have found that tenure is a primary driver of our collector effectiveness. We offer our collectors a competitive wage with the opportunity to receive unlimited incentive compensation based on performance, as well as an attractive benefits package, a comfortable working environment and the ability to work on a flexible schedule. Stock options were awarded to many of our collectors at the time of our IPO, and many tenured collectors were awarded nonvested shares in 2004, 2005 and 2006. We have a comprehensive six week training program for new owned portfolio collectors and provide continuing advanced training classes which are conducted in our four training centers. Recognizing the demands of the job, our management team has endeavored to create a professional and supportive environment for all of our employees.

Established Systems and Infrastructure

We have devoted significant effort to developing our systems, including statistical models, databases and reporting packages, to optimize our portfolio purchases and collection efforts. In addition, we believe that our technology infrastructure is flexible, secure, reliable and redundant, to ensure the protection of our sensitive data and to mitigate exposure to systems failure or unauthorized access. We believe that our systems and infrastructure give us meaningful advantages over our competitors. We have developed financial models and systems for pricing portfolio acquisitions, managing the collections process and monitoring operating results. We perform a static pool analysis monthly on each of our portfolios, inputting actual results back into our acquisition models, to enhance their accuracy. We monitor collection results continuously, seeking to identify and resolve negative trends immediately. Our comprehensive management reporting package is designed to fully inform our management team so that they may make timely operating decisions. This combination of hardware, software and proprietary modeling and systems has been developed by our management team through years of experience in this industry and we believe provides us with an important competitive advantage from the acquisition process all the way through collection operations.

Strong Relationships with Major Credit Originators

We have done business with most of the top consumer lenders in the United States. We maintain an extensive marketing effort and our senior management team is in contact on a regular basis with known and prospective credit originators. We believe that we have earned a reputation as a reliable purchaser of defaulted consumer receivables portfolios and as responsible collectors. Furthermore, from the perspective of the selling credit originator, the failure to close on a negotiated sale of a portfolio consumes valuable time and expense and can have an adverse effect on pricing when the portfolio is re-marketed. We have never been unable to close on a transaction. Similarly, if a credit originator sells a portfolio to a debt buyer which has a reputation for violating industry standard collecting practices, it can taint the reputation of the credit originator. We go to great lengths to collect from consumers in a responsible, professional and legally compliant manner. We believe our strong relationships with major credit originators provide us with access to quality opportunities for portfolio purchases and contingent fee collection placements.

Experienced Management Team

We have an experienced management team with considerable expertise in the accounts receivable management industry. Prior to our formation, our founders played key roles in the development and management of a consumer receivables acquisition and divestiture operation of Household Recovery Services, a subsidiary of Household International, now owned by HSBC. As we have grown, the original management team has been expanded to include a group of experienced, seasoned executives.

Portfolio Acquisitions

Our portfolio of defaulted consumer receivables includes a diverse set of accounts that can be categorized by asset type, age and size of account, level of previous collection efforts and geography. To identify attractive buying opportunities, we maintain an extensive marketing effort with our senior officers contacting known and prospective sellers of defaulted consumer receivables. We acquire receivables of Visa®, MasterCard® and Discover® credit cards, private label credit cards, installment loans, lines of credit, bankrupt accounts, deficiency balances of various types, legal judgments, and trade payables, all from a variety of debt owners. These debt owners include major banks, credit unions, consumer finance companies, telecommunication providers, retailers, utilities, insurance companies, medical groups/hospitals, other debt buyers and auto finance companies. In addition, we exhibit at trade shows, advertise in a variety of trade publications and attend industry events in an effort to develop account purchase opportunities. We also maintain active relationships with brokers of defaulted consumer receivables.

The following chart categorizes our life to date owned portfolios as of December 31, 2007 into the major asset types represented.

Asset Type	No. of Accounts	%	Life to Date Purchased Face Value of Defaulted Consumer Receivables [(1)]	%
Visa/MasterCard/Discover	9,493,347	56.8%	$ 25,864,304,255	73.2%
Consumer Finance	4,170,594	24.9%	3,674,355,405	10.4%
Private Label Credit Cards	2,632,051	15.7%	3,192,876,381	9.0%
Auto Deficiency	430,855	2.6%	2,601,308,663	7.4%
Total:	**16,726,847**	**100.0%**	**$ 35,332,844,704**	**100.0%**

(1) The Life to Date Purchased Face Value of Defaulted Consumer Receivables represents the original face amount purchased from sellers and has not been decremented by any adjustments including payments and buybacks (buybacks are defined as purchase price refunded by the seller due to the return of non-compliant accounts).

We have done business with most of the largest consumer lenders in the United States. Since our formation, we have purchased accounts from approximately 140 debt owners.

We have acquired portfolios at various price levels, depending on the age of the portfolio, its geographic distribution, our historical experience with a certain asset type or credit originator and similar factors. A typical defaulted consumer receivables portfolio ranges from $1 million to $150 million in face value and contains defaulted consumer receivables from diverse geographic locations with average initial individual account balances of $400 to $7,000.

The age of a defaulted consumer receivables portfolio (the time since an account has been charged-off) is an important factor in determining the price at which we will purchase a receivables portfolio. Generally, there is an inverse relationship between the age of a portfolio and the price at which we will purchase the portfolio. This relationship is due to the fact that older receivables typically are more difficult to collect. The accounts receivables management industry places receivables into categories depending on the number of collection agencies that have previously attempted to collect on the receivables. Fresh accounts are typically past due 120 to 270 days and charged-off by the credit originator, that are either being sold prior to any post-charge-off collection activity or are placed with a third-party for the first time. These accounts typically sell for the highest purchase price. Primary accounts are typically 360 to 450 days past due and charged-off, have been previously placed with one contingent fee servicer and receive a lower purchase price. Secondary and tertiary accounts are typically more than 660 days past due and charged-off, have been placed with two or three contingent fee servicers and receive even lower purchase prices. We also purchase accounts previously worked by four or more agencies and these are typically 1,260 days or more past due and receive an even lower price.

As shown in the following chart, as of December 31, 2007, we purchase or service accounts at any point in the delinquency cycle.

Account Type	**No. of Accounts**	**%**		**Life to Date Purchased Face Value of Defaulted Consumer Receivables[(1)]**	**%**
Fresh	437,054	2.6%	$	1,837,133,694	5.2%
Primary	1,751,591	10.5%		3,411,142,798	9.7%
Secondary	2,606,072	15.6%		4,496,690,016	12.7%
Tertiary	3,402,180	20.3%		4,297,282,044	12.2%
BK Trustees	1,819,365	10.9%		7,510,751,231	21.3%
Other	6,710,585	40.1%		13,779,844,921	38.9%
Total:	**16,726,847**	**100.0%**	**$**	**35,332,844,704**	**100.0%**

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

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

The following chart sets forth our overall life to date portfolio of defaulted consumer receivables geographically as of December 31, 2007:

Geographic Distribution	**No. of Accounts**	**%**	**Life to Date Purchased Face Value of Defaulted**	**%**	**Original Purchase Price of Defaulted Consumer Receivables[(2)]**	**%**

			Consumer Receivables [1]			
Texas	2,985,339	18%	$ 4,572,650,090	13%	$ 91,113,655	12%
California	1,670,186	10%	4,287,048,493	12%	79,953,070	10%
Florida	1,291,026	8%	3,443,924,244	10%	67,166,072	8%
New York	975,063	6%	2,394,086,021	7%	53,037,698	7%
Pennsylvania	584,555	3%	1,409,982,169	4%	34,734,815	4%
Illinois	645,103	4%	1,181,261,995	3%	29,909,745	4%
North Carolina	563,082	3%	1,213,756,630	3%	28,573,672	4%
New Jersey	389,348	2%	1,091,712,754	3%	23,826,008	3%
Ohio	523,074	3%	1,095,906,170	3%	29,930,960	4%
Georgia	497,371	3%	1,068,311,899	3%	29,803,024	4%
Michigan	438,014	3%	868,856,012	2%	23,644,643	3%
Massachusetts	319,863	2%	738,152,928	2%	15,678,219	2%
Arizona	257,320	2%	656,116,498	2%	12,783,899	2%
Virginia	324,516	2%	673,479,899	2%	17,505,830	2%
South Carolina	298,489	2%	657,881,226	2%	15,002,918	2%
Tennessee	329,601	2%	707,781,156	2%	19,927,659	3%
Other [3]	4,634,897	27%	9,271,936,520	27%	219,034,475	26%
Total:	**16,726,847**	**100%**	**$ 35,332,844,704**	**100%**	**$ 791,626,362**	**100%**

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

(2) The Original Purchase Price of Defaulted Consumer Receivables represents the cash paid to sellers to

acquire portfolios of defaulted consumer receivables.

(3) Each state included in "Other" represents less than 2% of the face value of total defaulted consumer receivables.

Purchasing Process

We acquire portfolios from debt owners through auctions and negotiated sales. In an auction process, the seller will assemble a portfolio of receivables and will either broadly offer the portfolio to the market or seek purchase prices from specifically invited potential purchasers. In a privately negotiated sale process, the debt owner will contact known, reputable purchasers directly, take bids and negotiate the terms of sale. We also acquire accounts in forward flow contracts. Under a forward flow contract, we agree to purchase defaulted consumer receivables from a debt owner on a periodic basis, at a set percentage of face value of the receivables over a specified time period. These agreements typically have a provision requiring that the attributes of the receivables to be sold will not significantly change each month and that the debt owner efforts to collect these receivables will not change. If this provision is not adhered to, the contract will allow for the early termination of the forward flow contract by the purchaser or call for a price renegotiation. Forward flow contracts are a consistent source of defaulted consumer receivables for accounts receivables management providers and provide the debt owner with a reliable source of revenue and a professional resolution of defaulted consumer receivables.

In a typical sale transaction, a debt owner distributes a computer data file containing ten to fifteen basic data fields on each receivables account in the portfolio offered for sale. Such fields typically include the consumer s name, address, outstanding balance, date of charge-off, date of last payment and the date the account was opened. We perform our initial due diligence on the portfolio by electronically cross-checking the data fields on the computer disk or data tape against the accounts in our owned portfolios and against national demographic and credit databases. We compile a variety of portfolio level reports examining all demographic data available. When valuing pools of bankrupt consumer receivables, we seek to access information on the status of each account s bankruptcy case.

In order to determine a purchase price for a portfolio, we use two separate internally developed computer models and one externally developed model, which we may supplement with on-site due diligence of the seller s collection operation and/or a review of their loan origination files, collection notes and work processes. We analyze the portfolio using our proprietary multiple regression model, which analyzes each account of the portfolio using variables in the regression model. In addition, we analyze the portfolio as a whole using an adjustment model, which uses an appropriate cash flow model depending upon whether it is a purchase of fresh, primary, secondary or tertiary accounts. Then, adjustments can be made to the cash flow model to compensate for demographic attributes supported by a detailed analysis of demographic data. Finally, we use a model that creates statistically similar portfolios from our existing accounts and develops collection curves for them that are used in our price modeling. From these models we derive our quantitative purchasing analysis which is used to help price transactions. The multiple regression model is also used to prioritize collection work efforts subsequent to purchase. With respect to prospective forward flow contracts and other long-term relationships, in addition to the procedures outlined above, as we receive new flows under the aforementioned contract we may obtain a representative test portfolio to evaluate and compare the performance of the portfolio to the projections we developed in our purchasing analysis. In addition, when purchasing bankrupt consumer receivables, we utilize a specifically designed pricing model.

Our due diligence and portfolio review results in a comprehensive analysis of the proposed portfolio. This analysis compares defaulted consumer receivables in the prospective portfolio with our collection history in similar portfolios. We then use our multiple regression model to value each account. Finally, we use the statistically similar portfolio analysis model to refine our curves. Using the three valuation approaches, we determine cash collections over the life of the portfolio. We then summarize all anticipated cash collections and associated direct expenses and project a collectibility value expressed both in dollars and liquidation percentage and a detailed expense projection over the portfolio s estimated six to ten year economic life. We use the total projected collectibility value and expenses to determine an appropriate purchase price.

We maintain a detailed static pool analysis on each portfolio that we have acquired, capturing all demographic data and revenue and expense items for further analysis. We use the static pool analysis to refine the underwriting models that we use to price future portfolio purchases. The results of the static pool analysis are input back into our models, increasing the accuracy of the models as the data set increases with every portfolio purchase and each day s collection efforts.

The quantitative and qualitative data derived in our due diligence is evaluated together with our knowledge of the current defaulted consumer receivables market and any subjective factors about the portfolio or the debt owner of which management may be aware. A portfolio acquisition approval memorandum is prepared for each prospective portfolio before a purchase price is submitted to the debt owner. This approval memorandum, which outlines the portfolio s anticipated collectibility and purchase structure, is distributed to members of our Investment Committee. The approval by the Committee sets a maximum purchase price for the portfolio. The Investment Committee is currently comprised of Steve Fredrickson, Chief Executive Officer and President, Kevin Stevenson, Chief Financial and Administrative Officer and Craig Grube, Executive Vice President Acquisitions.

Once a portfolio purchase has been approved by our investment committee and the terms of the sale have been agreed to with the debt owner, the acquisition is documented in an agreement that contains customary terms and conditions. Provisions are typically incorporated for bankrupt, disputed, fraudulent or deceased accounts and typically, the debt owner either agrees to repurchase these accounts or replace them with acceptable replacement accounts within certain time frames.

Owned Collection Operations

Our work flow management system places, recalls and prioritizes accounts in collectors work queues, based on our analyses of our accounts and other demographic, credit and prior work collection attributes. We use this process to focus our work effort on those consumers most likely to pay on their accounts and to rotate to other collectors the non-paying but most likely to pay accounts from which other collectors have been unsuccessful in receiving payment. The majority of our collections occur as a result of telephone contact with consumers.

The collectibility forecast for a newly acquired portfolio will help determine collection strategy. Accounts which are determined to have the highest predicted collection probability may be sent immediately to collectors work queues. Less collectible accounts may be set aside as house accounts to be collected using a predictive dialer or another passive, low cost method. Some accounts may be worked using a letter and/or settlement strategy. We may obtain credit reports for various accounts after the collection process begins. When a collector establishes contact with a consumer, the account information is placed automatically in the collector s work queue.

Our computer system allows each collector to view all the scanned documents relating to the consumer s account, which can include the original account application and payment checks. A typical collector work queue may include 650 to 1,000 accounts or more, depending on the skill level and tenure of the collector. The work queue is depleted and replenished automatically by our computerized work flow system.

On the initial contact call, the consumer is given a standardized presentation regarding the benefits of resolving his or her account with us. Emphasis is placed on determining the reason for the consumer s default in order to better assess the consumer s situation and create a plan for repayment. The collector is incentivized to have the consumer pay the full balance of the account. If the collector cannot obtain payment of the full balance, the collector will suggest a repayment plan which generally includes an approximate 20% down payment with the balance to be repaid over an agreed upon period. At times, when determined to be appropriate, and in many cases with management approval, a reduced lump-sum settlement may be agreed upon. If the consumer elects to utilize an installment plan, we have developed a system which enables us to make withdrawals from a consumer s bank account, in accordance with the directions of the customer.

If a collector is unable to establish contact with a consumer based on information received, the collector must undertake skip tracing procedures to develop important account information. Skip tracing is the process of developing new phone, address, job or asset information on a consumer, or verifying the accuracy of such information. Each collector does his or her own skip tracing using a number of computer applications available at his or her workstation, as well as a series of automated skip tracing procedures implemented by us on a regular basis.

Accounts for which the consumer has the likely ability, but not the willingness, to resolve their obligations are reviewed for legal action. Depending on the balance of the defaulted consumer receivable and the applicable state collection laws, we determine whether to commence legal action to judicially collect on the receivable. The legal process can take an extended period of time, but it also generates cash collections that likely would not have been realized otherwise.

Our legal recovery department oversees our internal legal collections and coordinates an independent nationwide collections attorney network which is responsible for the preparation and filing of judicial collection proceedings in multiple jurisdictions, determining the suit criteria, coordinating sales of property and instituting wage garnishments to satisfy judgments. This network consists of approximately 70 independent law firms who work on a flat fee or contingent fee basis. Legal cash collections currently constitute approximately 32% of our total cash collections. As our portfolio matures, a larger number of accounts will be directed to our legal recovery department for judicial collection; consequently, we anticipate that legal cash collections will grow commensurately and comprise a larger percentage of our total cash collections. During 2004, we began using a combination of internal staff (attorney and support), as well as external attorneys, to pursue legal collections in certain states and under certain circumstances. This has grown to over 40 states, utilizing the lower courts, in which we initiate law suits in amounts up to the jurisdictional limits of the respective courts. This distribution channel allows us to work accounts that we would not normally pursue through the use of contingent fee collection attorneys because of cost. Our legal recovery department also collects claims against estates in cases involving deceased debtors having assets at the time of death.

Our bankruptcy department files proofs of claim (POCs) and performs all administrative functions and tracking on accounts that are included in consumer bankruptcies filed under Chapter 13 of the U.S. Bankruptcy Code in order to substantiate our claims and ensure that we participate in any distributions to creditors.

Fee-for-Service Businesses

In order to provide debt owners with alternative collection solutions and to capitalize on common competencies between a fee-for-service collections operation and an acquired receivables portfolio business, we commenced our ARM third-party contingent fee collections operation in March 2001. In a contingent fee arrangement, debt owners typically place defaulted receivables with a third party collection agency once they have ceased their recovery efforts. The debt owners then pay the third-party agency a commission fee based upon the amount actually collected from the consumer. A contingent fee placement of defaulted consumer receivables is usually for a fixed time frame, typically four to six months, or as long as twelve months. At the end of this fixed period, the third-party agency will return the uncollected defaulted consumer receivables to the debt owner, which may then place the defaulted consumer receivables with another collection agency or sell the portfolio of receivables.

The determination of the commission fee to be paid for third-party collections is generally based upon the age and potential collectibility of the defaulted consumer receivables being assigned for placement. For example, if there has been no prior third-party collection activity with respect to the defaulted consumer receivables, the commission fee would be lower than if there had been one or more previous collection agencies attempting to collect on the receivables. The earlier the placement of defaulted consumer receivables in the collection process, the higher the probability of receiving a cash collection and, therefore, the lower the cost to collect and the lower the commission fee. Other factors, such as the location of the consumers, the size of the defaulted consumer receivables, competition among third party agencies, and the clients collection procedures and work standards also contribute to establishing a commission fee.

Revenues from IGS are accounted for as commission revenue. IGS performs national skip tracing, asset location and collateral recovery services, principally for auto finance companies, for a fee. The amount of fee earned is generally dependent on several different outcomes: whether the debtor was found and a resolution on the account occurred, if the collateral was repossessed or if payment was made by the debtor to the debt owner. For example, if the debtor is not found, our fee is less than if the debtor is found and we are able to create a positive resolution on the account.

RDS computes revenue using both of the aforementioned approaches. RDS collects delinquent taxes and earns a contingent fee. This fee can vary based on the age of the debt being collected. RDS also processes tax payments for taxing authorities. For this work, we are paid a fee for each transaction. RDS also performs tax audit services, for which we are paid either an hourly rate or a contingency fee as well as unclaimed property audits for which we are paid a contingency fee. RDS provides local and state governments with a range of revenue enhancement services including revenue administration, revenue discovery and recovery, aged receivables management and compliance auditing.

Competition

We face competition in both of the markets we serve owned portfolio and fee-for-service accounts receivable management from new and existing providers of outsourced receivables management services, including other purchasers of defaulted consumer receivables portfolios, third-party contingent fee collection agencies and debt owners that manage their own defaulted consumer receivables rather than outsourcing them. The accounts receivable management industry (owned portfolio and contingent fee) is highly fragmented and competitive, consisting of approximately 6,000 consumer and commercial agencies. We estimate that more than 90% of these agencies compete in the contingent fee market. There are few significant barriers for entry to new providers of contingent fee receivables management services and, consequently, the number of agencies serving the contingent fee market may continue to grow. Greater capital needs and the need for portfolio evaluation expertise sufficient to price portfolios effectively constitute significant barriers for entry to new providers of owned portfolio receivables management services.

We face bidding competition in our acquisition of defaulted consumer receivables and in obtaining placement of fee-for-service receivables. We also compete on the basis of reputation, industry experience and performance. Among the positive factors which we believe influence our ability to compete effectively in this market are our ability to bid on portfolios at appropriate prices, our reputation from previous transactions regarding our ability to close transactions in a timely fashion, our relationships with originators of defaulted consumer receivables, our team of well-trained collectors who provide quality customer service and compliance with applicable collections laws, our ability to collect on various asset types and our ability to provide both purchased and contingent fee solutions to debt owners. Among the negative factors which we believe could influence our ability to compete effectively in this market are that some of our current competitors and possible new competitors may have substantially greater financial, personnel and other resources, greater adaptability to changing market needs, longer operating histories and more established relationships in our industry than we currently have.

Information Technology

Technology Operating Systems and Server Platform

The scalability of our systems provides us with a technology system that is flexible, secure, reliable and redundant to ensure the protection of our sensitive data. We utilize Intel-based servers running industry standard open systems coupled with Microsoft Windows 2000/2003 and NT Server operating systems. In addition, we utilize a blend of purchased and proprietary software systems tailored to the needs of our business. These systems are designed to eliminate inefficiencies in our collections, continue to meet business objectives in a changing environment and meet compliance obligations with regulatory entities. Our proprietary hardware and software systems are being leveraged to manage location information, phone and operational applications for IGS and RDS. We believe our custom solutions will enhance the overall investigative capabilities of this business while meeting compliance obligations with regulatory entities.

Network Technology

To provide delivery of our applications, we utilize Intel-based workstations across our entire business operations. The environment is configured to provide speeds of 100 megabytes to the desktops of our collections and administration staff. Our one gigabyte server network architecture supports high-speed data transport. Our network system is designed to be scalable and meet expansion and inter-building bandwidth and quality of service demands.

Database and Software Systems

The ability to access and utilize data is essential to us being able to operate nationwide in a cost-effective manner. Our centralized computer-based information systems support the core processing functions of our business under a set of integrated databases and are designed to be both replicable and scalable to accommodate our internal growth. This integrated approach helps to assure that consistent sources are processed efficiently.

We use these systems for portfolio and client management, skip tracing, check taking, financial and management accounting, reporting, and planning and analysis. The systems also support our consumers, including on-line access to account information, account status and payment entry. We use a combination of Microsoft, Oracle and Cache database software to manage our portfolios, financial, customer and sales data, and we believe these systems will be sufficient for our needs for the foreseeable future. RDS maintains a unique, proprietary software system that manages the movement of data, accounts and information throughout the unit. We believe this system will be sufficient for our needs in the foreseeable future. Our contingent fee collections operations database incorporates an integrated and proprietary predictive dialing platform used with our predictive dialer discussed below.

Redundancy, System Backup, Security and Disaster Recovery

Our data centers provide the infrastructure for innovative collection services and uninterrupted support of hardware and server management, server co-location and an all-inclusive server administration for our business. We believe our facilities and operations include sufficient redundancy, file back-up and security to ensure minimal exposure to systems failure or unauthorized access. The preparations in this area include the use of call centers in Virginia, Kansas, Alabama and Tennessee in order to help provide redundancy for data and processes should one site be completely disabled. We have a disaster recovery plan covering our business that is tested on a periodic basis. The combination of our locally distributed call control systems provides enterprise-wide call and data distribution between our call centers for efficient portfolio collection and business operations. In addition to data replication between the sites, incremental backups of both software and databases are performed on a daily basis and a full system backup is performed weekly. Backup data tapes are stored at an offsite location along with copies of schedules and production control procedures, procedures for recovery using an off-site data center, documentation and other critical information necessary for recovery and continued operation. Our Virginia headquarters has two separate power and telecommunications feeds, an uninterruptible power supply and a diesel-generator power plant, all of which provide a level of redundancy should a power outage or interruption occur. We also have generators installed at our Hampton, Kansas, Tennessee and Alabama locations. We also employ rigorous physical and electronic security to protect our data. Our call centers have restricted card key access and appropriate additional physical security measures. Electronic protections include data encryption, firewalls and multi-level access controls. The facilities which currently house IGS and RDS feature uninterruptible power supply units and electronic protections. Full-scale site power, telecommunication and all of the other systems abilities of our other sites will be installed at IGS at a later time.

Plasma Displays for Real Time Data Utilization

We utilize plasma displays at our main facility to aid in recovery of portfolios. The displays provide real-time business-critical information to our collection personnel for efficient collection efforts such as telephone, production, employee status, goal trending, training and corporate information.

Predictive Dialer Technology

The Avaya Proactive Contact Dialer ensures that our collection staff focuses on certain defaulted consumer receivables according to our specifications. Our predictive dialer takes account of all campaign and dialing parameters and is able to automatically adjust its dialing pace to match changes in campaign conditions and provide the lowest possible wait times and abandon rates. In addition, the dialer allows our collectors to only handle live voice calls by leaving automated messages on all calls where answering machines are detected. This feature allows our representatives to speak with more debtors per agent hour, and also increases our inbound call volume.

Employees

We employed 1,677 persons on a full-time basis, including the following number of front line operations employees by business: 1,240 on our owned portfolios, 67 working in our ARM contingent fee collections operations, 130 working in our IGS operations and 41 working in our RDS government collections operation, as of December 31, 2007. None of our employees are represented by a union or covered by a collective bargaining agreement. We believe that our relations with our employees are good.

Hiring

We recognize that our collectors are critical to the success of our business as a majority of our collection efforts occur as a result of telephone contact with consumers. We have found that the tenure and productivity of our collectors are directly related. Therefore, attracting, hiring, training, retaining and motivating our collection personnel is a major focus for us. We pay our collectors competitive wages and offer employees a full benefits program which includes comprehensive medical coverage, short and long term disability, life insurance, dental and vision coverage, pre-paid legal plan, an employee assistance program, supplemental indemnity, cancer, hospitalization, accident insurance, a flexible spending account for child care and a matching 401(k) program. In addition to a base wage, we provide collectors with the opportunity to receive unlimited compensation through an incentive compensation program that pays bonuses above a set monthly base, based upon each collector s collection results. This program is designed to ensure that employees are paid based not only on performance, but also on consistency. We have awarded stock based compensation to many of our tenured collectors. We believe that these practices have helped us achieve an annual post-training turnover rate of 54% in 2007.

A large number of telemarketing, customer-service and reservation phone centers are located near our Virginia headquarters. We believe that we offer a competitive and, in many cases, a higher base wage than many local employers and therefore have access to a large number of eligible personnel. In addition, there are several military bases in the area. We employ numerous military spouses and retirees and find them to be an excellent source of employees. We have also found the Las Vegas, Nevada, Hutchinson, Kansas, Birmingham, Alabama and Jackson, Tennessee areas to provide a large potential workforce of eligible personnel.

Training

We provide a comprehensive six week training program for all new owned portfolio collectors. The first three weeks of the training program is comprised of lectures to learn collection techniques, state and federal collection laws, systems, negotiation skills, skip tracing and telephone use. These sessions are then followed by an additional three weeks of practical experience conducting live calls with additional managerial supervision in order to provide employees with confidence and guidance while still contributing to our profitability. Each trainee must successfully pass a comprehensive examination before being assigned to the collection floor, as well as once a year thereafter. In addition, we conduct continuing advanced classes in our four training centers. Our technology and systems allow us to monitor individual employees and then offer additional training in areas of deficiency to increase productivity and ensure compliance.

Outsourced Collections Department

Legal Recovery

An important component of our collections effort involves our outsourced collections department and the judicial collection of accounts of customers who have the ability, but not the willingness, to resolve their obligations. Accounts for which the consumer is not cooperative and for which we can establish a garnishable job or attachable asset are reviewed for legal action. Additionally, we periodically review accounts using a proprietary scoring model and select those accounts reflecting a high propensity to pay in a legal environment. Depending on the balance of the defaulted consumer receivable and the applicable state collection laws, we determine whether to commence legal action to collect on the receivable. The legal process can take an extended period of time, but it also generates cash collections that likely would not have been realized otherwise. Our legal recovery department oversees internal legal collections and coordinates an independent nationwide attorney network which is responsible for the preparation and filing of judicial collection proceedings in multiple jurisdictions, determining the suit criteria, coordinating sales of property and instituting wage garnishments to satisfy judgments. This nationwide collections attorney network consists of approximately 70 independent law firms, all of which work on a contingent fee basis. Legal cash collections currently constitute approximately 32% of our total collections. As our portfolio matures, a larger number of accounts will be directed to our outsourced collections department for judicial collection; consequently, we anticipate that legal collections will grow commensurately and comprise a larger percentage of our total cash collections. During 2004, we began using a combination of internal staff (attorney and support), as well as external attorneys, to pursue legal collections in certain states and under certain circumstances. This has grown to 40 states, utilizing the lower courts, in which we initiate law suits in amounts up to the jurisdictional limits of the respective courts. This distribution channel allows us to work accounts that we would not normally pursue through the use of contingent fee collection attorneys because of cost. Our legal recovery department also collects claims against estates in cases involving deceased debtors having assets at the time of death.

Bankruptcy

Our bankruptcy department files proofs of claim (POCs) and performs all administrative functions and tracking on accounts that are included in consumer bankruptcies filed under Chapter 13 of the U.S. Bankruptcy Code in order to substantiate our claims and ensure that we participate in any distributions to creditors.

Corporate Legal Department

Our corporate legal department manages general corporate governance, litigation management, insurance management and risk assessment, corporate transactions, intellectual property, contract and document preparation and review, including real estate purchase and lease agreements and portfolio purchase documents, federal securities law and other regulatory and statutory compliance, obtaining and maintaining multi-state licensing, bonding and insurance and dispute and complaint resolution. As a part of its compliance functions, our corporate legal department works with our internal auditor and the Audit Committee of our Board of Directors in the implementation of our Code of Ethics. In that connection, we have implemented company wide ethics training and mandatory ethics quizzes and have established a confidential telephone hotline to report suspected policy violations, fraud, embezzlement, deception in record keeping and reporting, accounting, auditing matters and other acts which are inappropriate, criminal and/or unethical. Our Code of Ethics Policy is available at the Investor Relations page of our website. Our corporate legal department also provides guidance to our quality control department and assists with training our staff in relevant areas including extensive training on the Fair Debt Collection Practices Act and other relevant laws and regulations. Our corporate legal department distributes guidelines and procedures for collection personnel to follow when communicating with customers, customer s agents, attorneys and other parties during our recovery efforts. This includes overseeing the letter process and approving all written communications to account debtors. In addition, our corporate legal department regularly researches, and provides collections personnel and our training department with summaries and updates of changes in, federal and state statutes and relevant case law, so that they are aware of and in compliance with changing laws and judicial decisions when skip-tracing or collecting accounts.

Regulation

Federal and state statutes establish specific guidelines and procedures which debt collectors must follow when collecting consumer accounts. It is our policy to comply with the provisions of all applicable federal laws and comparable state statutes in all of our recovery activities, even in circumstances in which we may not be specifically subject to these laws. Our failure to comply with these laws could have a material adverse effect on us in the event and to the extent that they apply to some or all of our recovery activities. Federal and state consumer protection, privacy and related laws and regulations extensively regulate the relationship between debt collectors and debtors, and the relationship between customers and credit card issuers. Significant federal laws and regulations applicable to our business as a debt collector include the following:

Fair Debt Collection Practices Act. This act imposes certain obligations and restrictions on the practices of debt collectors, including specific restrictions regarding communications with consumer customers, including the time, place and manner of the communications. This act also gives consumers certain rights, including the right to dispute the validity of their obligations and a right to sue debt collectors who fail to comply with its provisions, including the right to recover their attorney fees.

Fair Credit Reporting Act. This act places certain requirements on credit information providers regarding verification of the accuracy of information provided to credit reporting agencies and investigating consumer disputes concerning the accuracy of such information. We provide information concerning our accounts to the three major credit reporting agencies, and it is our practice to correctly report this information and to investigate credit reporting disputes. The Fair and Accurate Credit Transactions Act amended the Fair Credit Reporting Act to include additional duties applicable to data furnishers with respect to information in the consumer s credit file that the consumer identifies as resulting from identity theft, and requires that data furnishers have procedures in place to prevent such information from being furnished to credit reporting agencies.

Gramm-Leach-Bliley Act. This act requires that certain financial institutions, including collection agencies, develop policies to protect the privacy of consumers private financial information and provide notices to consumers advising them of their privacy policies. This act also requires that if private personal information concerning a consumer is shared with another unrelated institution, the consumer must be given an opportunity to opt out of having such information shared. Since we do not share consumer information with non-related entities, except as required by law, or except as needed to collect on the receivables, our consumers are not entitled to any opt-out rights under this act. This act is enforced by the Federal Trade Commission, which has retained exclusive jurisdiction over its enforcement, and does not afford a private cause of action to consumers who may wish to pursue legal action against a financial institution for violations of this act.

Electronic Funds Transfer Act. This act regulates the use of the Automated Clearing House (ACH) system to make electronic funds transfers. All ACH transactions must comply with the rules of the National Automated Check Clearing House Association (NACHA) and Uniform Commercial Code § 3-402. This act, the NACHA regulations and the Uniform Commercial Code give the consumer, among other things, certain privacy rights with respect to the transactions, the right to stop payments on a pre-approved fund transfer, and the right to receive certain documentation of the transaction. This act also gives consumers a right to sue institutions which cause financial damages as a result of their failure to comply with its provisions.

Telephone Consumer Protection Act. In the process of collecting accounts, we use automated predictive dialers to place calls to consumers. This act and similar state laws place certain restrictions on telemarketers and users of automated dialing equipment who place telephone calls to consumers.

Servicemembers Civil Relief Act. The Soldiers and Sailors Civil Relief Act of 1940 was amended in December 2003 as the Servicemembers Civil Relief Act (SCRA). The SCRA gives U.S. military service personnel relief from credit obligations they may have incurred prior to entering military service, and may also apply in certain circumstances to obligations and liabilities incurred by a servicemember while serving on active duty. The SCRA prohibits creditors from taking specified actions to collect the defaulted accounts of servicemembers. The SCRA impacts many different types of credit obligations, including installment contracts and court proceedings, and tolls the statute of limitations during the time that the servicemember is engaged in active military service. The SCRA also places a cap on interest bearing obligations of servicemembers to an amount not greater than 6% per year, inclusive of all related charges and fees.

Health Insurance Portability and Accountability Act. The Health Insurance Portability and Accountability Act (HIPAA) provides standards to protect the confidentiality of patients personal healthcare and financial information. Pursuant to HIPAA, business associates of health care providers, such as agencies which collect healthcare receivables, must comply with certain privacy and security standards established by HIPAA to ensure that the information provided will be safeguarded from misuse. This act is enforced by the Department of Health and Human Services and does not afford a private cause of action to consumers who may wish to pursue legal action against an institution for violations of this act.

U.S. Bankruptcy Code. In order to prevent any collection activity with bankrupt debtors by creditors and collection agencies, the U.S. Bankruptcy Code provides for an automatic stay, which prohibits certain contacts with consumers after the filing of bankruptcy petitions.

Additionally, there are some states statutes and regulations comparable to the above federal laws, and specific licensing requirements which affect our operations. State laws may also limit credit account interest rates and the fees, as well as limit the time frame in which judicial actions may be initiated to enforce the collection of consumer accounts.

Although we are not a credit originator, some of these laws directed toward credit originators may occasionally affect our operations because our receivables were originated through credit transactions, such as the following laws, which apply principally to credit originators:

Truth in Lending Act;

Fair Credit Billing Act; and

Equal Credit Opportunity Act.

Federal laws which regulate credit originators require, among other things, that credit card issuers disclose to consumers the interest rates, fees, grace periods and balance calculation methods associated with their credit card accounts. Consumers are entitled under current laws to have payments and credits applied to their accounts promptly, to receive prescribed notices and to require billing errors to be resolved promptly. Some laws prohibit discriminatory practices in connection with the extension of credit. Federal statutes further provide that, in some cases, consumers cannot be held liable for, or their liability is limited with respect to, charges to the credit card account that were a result of an unauthorized use of the credit card. These laws, among others, may give consumers a legal cause of action against us, or may limit our ability to recover amounts owing with respect to the receivables, whether or not we committed any wrongful act or omission in connection with the account. If the credit originator fails to comply with applicable statutes, rules and regulations, it could create claims and rights for consumers that could reduce or eliminate their obligations to repay the account and have a possible material adverse effect on us.

Accordingly, when we acquire defaulted consumer receivables, we contractually require credit originators to indemnify us against any losses caused by their failure to comply with applicable statutes, rules and regulations relating to the receivables before they are sold to us.

The U.S. Congress and several states have enacted legislation concerning identity theft. Additional consumer protection and privacy protection laws may be enacted that would impose additional requirements on the enforcement of and recovery on consumer credit card or installment accounts. Any new laws, rules or regulations that may be adopted, as well as existing consumer protection and privacy protection laws, may adversely affect our ability to recover the receivables. In addition, our failure to comply with these requirements could adversely affect our ability to enforce the receivables.

We cannot assure you that some of the receivables were not established as a result of identity theft or unauthorized use of a credit card and, accordingly, we could not recover the amount of the defaulted consumer receivables. As a purchaser of defaulted consumer receivables, we may acquire receivables subject to legitimate defenses on the part of the consumer. Our account purchase contracts allow us to return to the debt owners certain defaulted consumer receivables that may not be collectible, due to these and other circumstances. Upon return, the debt owners are required to replace the receivables with similar receivables or repurchase the receivables. These provisions limit to some extent our losses on such accounts.

Item 1A. Risk Factors.

To the extent not described elsewhere in this Annual Report, the following are risks related to our business.

We may not be able to purchase defaulted consumer receivables at appropriate prices, and a decrease in our ability to purchase portfolios of receivables could adversely affect our ability to generate revenue

If we are unable to purchase defaulted receivables from debt owners at appropriate prices, or one or more debt owners stop selling defaulted receivables to us, we could lose a potential source of income and our business may be harmed.

The availability of receivables portfolios at prices which generate an appropriate return on our investment depends on a number of factors both within and outside of our control, including the following:

- the continuation of current growth trends in the levels of consumer obligations;
- sales of receivables portfolios by debt owners; and
- competitive factors affecting potential purchasers and credit originators of receivables.

Because of the length of time involved in collecting defaulted consumer receivables on acquired portfolios and the volatility in the timing of our collections, we may not be able to identify trends and make changes in our purchasing strategies in a timely manner.

We may be unable to obtain account documents for some of the accounts that we purchase. Our inability to provide account documents on accounts that are subject to judicial collections may negatively impact the liquidation rate on these accounts.

When we collect accounts judicially, courts in certain jurisdictions require that a copy of the account statements or applications be attached to the pleadings in order to obtain a judgment against the account debtors. If we are unable to produce account documents, these courts will deny our claims.

We may not be able to collect sufficient amounts on our defaulted consumer receivables to fund our operations

Our business primarily consists of acquiring and servicing receivables that consumers have failed to pay and that the credit originator has deemed uncollectible and has generally charged-off. The debt owners generally make numerous attempts to recover on their defaulted consumer receivables, often using a combination of in-house recovery efforts and third-party collection agencies. These defaulted consumer receivables are difficult to collect and we may not collect a sufficient amount to cover our investment associated with purchasing the defaulted consumer receivables and the costs of running our business.

We experience high employee turnover rates and we may not be able to hire and retain enough sufficiently trained employees to support our operations

The accounts receivables management industry is very labor intensive and, similar to other companies in our industry, we typically experience a high rate of employee turnover. Our annual turnover rate, excluding those employees that do not complete our six week training program, was 54% in 2007. We compete for qualified personnel with companies in our industry and in other industries. Our growth requires that we continually hire and train new collectors. A higher turnover rate among our collectors will increase our recruiting and training costs and limit the number of experienced collection personnel available to service our defaulted consumer receivables. If this were to occur, we would not be able to service our defaulted consumer receivables effectively and this would reduce our ability to continue our growth and operate profitability.

We serve markets that are highly competitive, and we may be unable to compete with businesses that may have greater resources than we have

We face competition in both of the markets we serve owned portfolio and fee based accounts receivable management from new and existing providers of outsourced receivables management services, including other purchasers of defaulted consumer receivables portfolios, third-party contingent fee collection agencies and debt owners that manage their own defaulted consumer receivables rather than outsourcing them. The accounts receivable management industry is highly fragmented and competitive, consisting of approximately 6,000 consumer and commercial agencies, most of which compete in the contingent fee business.

We face bidding competition in our acquisition of defaulted consumer receivables and in our placement of fee based receivables, and we also compete on the basis of reputation, industry experience and performance. Some of our current competitors and possible new competitors may have substantially greater financial, personnel and other resources, greater adaptability to changing market needs, longer operating histories and more established relationships in our industry than we currently have. In the future, we may not have the resources or ability to compete successfully. As there are few significant barriers for entry to new providers of fee based receivables management services, there can be no assurance that additional competitors with greater resources than ours will not enter the market. Moreover, there can be no assurance that our existing or potential clients will continue to outsource their defaulted consumer receivables at recent levels or at all, or that we may continue to offer competitive bids for defaulted consumer receivables portfolios. If we are unable to develop and expand our business or adapt to changing market needs as well as our current or future competitors are able to do, we may experience reduced access to defaulted consumer receivables portfolios at appropriate prices and reduced profitability.

We may not be successful at acquiring receivables of new asset types or in implementing a new pricing structure

We may pursue the acquisition of receivables portfolios of asset types in which we have little current experience. We may not be successful in completing any acquisitions of receivables of these asset types and our limited experience in these asset types may impair our ability to collect on these receivables. This may cause us to pay too much for these receivables and consequently, we may not generate a profit from these receivables portfolio acquisitions.

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In addition, we may in the future provide a service to debt owners in which debt owners will place consumer receivables with us for a specific period of time for a flat fee. This fee may be based on the number of collectors assigned to the collection of these receivables, the amount of receivables placed or other bases. We may not be successful in determining and implementing the appropriate pricing for this pricing structure, which may cause us to be unable to generate a profit from this business.

Our collections may decrease if certain types of bankruptcy filings involving liquidations increase

Various economic trends may contribute to an increase in the amount of personal bankruptcy filings. Under certain bankruptcy filings a debtor s assets may be sold to repay creditors, but since the defaulted consumer receivables we service are generally unsecured we often would not be able to collect on those receivables. We cannot ensure that our collection experience would not decline with an increase in personal bankruptcy filings or a change in bankruptcy regulations or practices. If our actual collection experience with respect to a defaulted bankrupt consumer receivables portfolio is significantly lower than we projected when we purchased the portfolio, our financial condition and results of operations could deteriorate.

We may make acquisitions that prove unsuccessful or strain or divert our resources

We intend to consider acquisitions of other companies in our industry that could complement our business, including the acquisition of entities offering greater access and expertise in other asset types and markets that are related but that we do not currently serve. If we do acquire other businesses, we may not be able to successfully integrate these businesses with our own and we may be unable to maintain our standards, controls and policies. Further, acquisitions may place additional constraints on our resources by diverting the attention of our management from other business concerns. Through acquisitions, we may enter markets in which we have no or limited experience. Moreover, any acquisition may result in a potentially dilutive issuance of equity securities, the incurrence of additional debt and amortization expenses of related intangible assets, all of which could reduce our profitability and harm our business.

The loss of IGS customers could negatively affect our operations

In October 2004 we acquired substantially all of the assets of IGS Nevada, Inc. A significant portion of the valuation was tied to existing client relationships. Our customers, in general, may terminate their relationship with us on 90 days prior notice. In the event a customer or customers terminate or significantly cut back any relationship with us, it could reduce our profitability and harm our business and could potentially give rise to an impairment charge related to an intangible asset specifically ascribed to existing client relationships.

We may not be able to continually replace our defaulted consumer receivables with additional receivables portfolios sufficient to operate efficiently and profitably

To operate profitably, we must continually acquire and service a sufficient amount of defaulted consumer receivables to generate revenue that exceeds our expenses. Fixed costs such as salaries and lease or other facility costs constitute a significant portion of our overhead and, if we do not continually replace the defaulted consumer receivables portfolios we service with additional portfolios, we may have to reduce the number of our collection personnel. We would then have to rehire collection staff as we obtain additional defaulted consumer receivables portfolios. These practices could lead to:

- low employee morale;
- fewer experienced employees;
- higher training costs;
- disruptions in our operations;
- loss of efficiency; and
- excess costs associated with unused space in our facilities.

Furthermore, heightened regulation of the credit card and consumer lending industry or changing credit origination strategies may result in decreased availability of credit to consumers, potentially leading to a future reduction in defaulted consumer receivables available for purchase from debt owners. We cannot predict how our ability to identify and purchase receivables and the quality of those receivables would be affected if there is a shift in consumer lending practices, whether caused by changes in the regulations or accounting practices applicable to debt owners, a sustained economic downturn or otherwise.

We may not be able to manage our growth effectively

We have expanded significantly since our formation and we intend to maintain our growth focus. However, our growth will place additional demands on our resources and we cannot ensure that we will be able to manage our growth effectively. In order to successfully manage our growth, we may need to:

- expand and enhance our administrative infrastructure;
- continue to improve our management, financial and information systems and controls; and
- recruit, train, manage and retain our employees effectively.

Continued growth could place a strain on our management, operations and financial resources. We cannot ensure that our infrastructure, facilities and personnel will be adequate to support our future operations or to effectively adapt to future growth. If we cannot manage our growth effectively, our results of operations may be adversely affected.

Our operations could suffer from telecommunications or technology downtime or increased costs

Our success depends in large part on sophisticated telecommunications and computer systems. The temporary or permanent loss of our computer and telecommunications equipment and software systems, through casualty or operating malfunction, could disrupt our operations. In the normal course of our business, we must record and process significant amounts of data quickly and accurately to access, maintain and expand the databases we use for our collection activities. Any failure of our information systems or software and our backup systems would interrupt our business operations and harm our business. Our headquarters are located in a region that is susceptible to hurricane damage, which may increase the risk of disruption of information systems and telephone service for sustained periods.

Further, our business depends heavily on services provided by various local and long distance telephone companies. A significant increase in telephone service costs or any significant interruption in telephone services could reduce our profitability or disrupt our operations and harm our business.

We may not be able to successfully anticipate, manage or adopt technological advances within our industry

Our business relies on computer and telecommunications technologies and our ability to integrate these technologies into our business is essential to our competitive position and our success. Computer and telecommunications technologies are evolving rapidly and are characterized by short product life cycles. We may not be successful in anticipating, managing or adopting technological changes on a timely basis.

While we believe that our existing information systems are sufficient to meet our current demands and continued expansion, our future growth may require additional investment in these systems. We depend on having the capital resources necessary to invest in new technologies to acquire and service defaulted consumer receivables. We cannot ensure that adequate capital resources will be available to us at the appropriate time.

Our senior management team is important to our continued success and the loss of one or more members of senior management could negatively affect our operations

The loss of the services of one or more of our key executive officers or key employees could disrupt our operations. We have employment agreements with Steve Fredrickson, our president, chief executive officer and chairman of our board of directors, Kevin Stevenson, our executive vice president and chief financial and administrative officer, Craig Grube, our executive vice president of portfolio acquisitions, and most of our other senior executives. The current agreements contain non-compete provisions that survive termination of employment. However, these agreements do not and will not assure the continued services of these officers and we cannot ensure that the non-compete provisions will be enforceable. Our success depends on the continued service and performance of our key executive officers, and we cannot guarantee that we will be able to retain those individuals. The loss of the services of Mr. Fredrickson, Mr. Stevenson, Mr. Grube or other key executive officers could seriously impair our ability to continue to acquire or collect on defaulted consumer receivables and to manage and expand our business. Under one of our credit agreements, if both Mr. Fredrickson and Mr. Stevenson cease to be president and chief financial and administrative officer, respectively, it would constitute a default.

Our ability to recover and enforce our defaulted consumer receivables may be limited under federal and state laws

Federal and state laws may limit our ability to recover and enforce our defaulted consumer receivables regardless of any act or omission on our part. Some laws and regulations applicable to credit issuers may preclude us from collecting on defaulted consumer receivables we purchase if the credit issuer previously failed to comply with applicable laws in generating or servicing those receivables. Collection laws and regulations also directly apply to our business. Additional consumer protection and privacy protection laws may be enacted that would impose additional requirements on the enforcement of and collection on consumer credit receivables. Any new laws, rules or regulations that may be adopted, as well as existing consumer protection and privacy protection laws, may adversely affect our ability to collect on our defaulted consumer receivables and may harm our business. In addition, federal and state governmental bodies are considering, and may consider in the future, legislative proposals that would regulate the collection of our defaulted consumer receivables. Additionally, the Bankruptcy Reform Act is expected to temporarily disrupt our historical bankruptcy collection curves, making it more difficult to accurately price bankrupt accounts that filed bankruptcy on or after October 17, 2005, the effective date of the Bankruptcy Reform Act. Further, new tax law changes such as Internal Revenue Code Section 6050P (requiring 1099-C returns to be filed on discharge of indebtedness in excess of $600) could negatively impact our ability to collect or cause us to incur additional expenses. Although we cannot predict if or how any future legislation would impact our business, our failure to comply with any current or future laws or regulations applicable to us could limit our ability to collect on our defaulted consumer receivables, which could reduce our profitability and harm our business. Our ability to recover on portfolios of bankrupt consumer receivables may be impacted by changes in federal laws or the change in administrative practices of the various bankruptcy courts.

Our ability to recover on portfolios of bankrupt consumer receivables may be impacted by changes in federal laws or the change in administrative practices of the various bankruptcy courts

We recover on consumer receivables that have filed for bankruptcy protection under available U.S. bankruptcy legislation. We recover on consumer receivables that have filed for bankruptcy protection after we acquired them, and we also purchase accounts that are currently in bankruptcy proceedings. Changes in bankruptcy laws may affect the process in which the various bankruptcy courts administer bankruptcy plans as well as our ability to recover on bankrupt consumer receivables.

We utilize the interest method of revenue recognition for determining our income recognized on finance receivables, which is based on an analysis of projected cash flows that may prove to be less than anticipated and could lead to reductions in future revenues or impairment charges

We utilize the interest method to determine income recognized on finance receivables. Under this method, static pools of receivables we acquire are modeled upon their projected cash flows. A yield is then established which, when applied to the unamortized purchase price of the receivables, results in the recognition of income at a constant yield relative to the remaining balance in the pool of defaulted consumer receivables. Each static pool is analyzed monthly to assess the actual performance compared to that expected by the model. If the accuracy of the modeling process deteriorates or there is a decline in anticipated cash flows, we would suffer reductions in future revenues or a decline in the carrying value of our receivables portfolios or impairment charges, which in any case would result in lower earnings in future periods and could negatively impact our stock price.

We may be required to incur impairment charges as a result of the application of American Institute of Certified Public Accountants Statement of Position 03-3

In October 2003, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position 03-3 (SOP 03-3), Accounting for Loans or Certain Securities Acquired in a Transfer. SOP 03-3 provides guidance on accounting for differences between contractual and expected cash flows from an investor s initial investment in loans or debt securities acquired in a transfer if those differences are attributable, at least in part, to credit quality. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 15, 2004 and amends Practice Bulletin 6 which remains in effect for loans acquired prior to the SOP 03-3 effective date. SOP 03-3 limits the revenue that may be accrued to the excess of the estimate of expected future cash flows over a portfolio s initial cost of accounts receivable acquired. SOP 03-3 requires that the excess of the contractual cash flows over expected cash flows not be recognized as an adjustment of revenue, expense, or on the balance sheet. SOP 03-3 initially freezes the internal rate of return, referred to as IRR, originally estimated when the accounts receivable are purchased for subsequent impairment testing. Rather than lower the estimated IRR if the original collection estimates are not received, effective January 1, 2005, the carrying value of a portfolio will be written down to maintain the then-current IRR. SOP 03-3 also amends Practice Bulletin 6 in a similar manner and applies to all loans acquired prior to January 1, 2005. Increases in expected future cash flows can be recognized prospectively through an upward adjustment of the IRR over a portfolio s remaining life. Any increased yield then becomes the new benchmark for impairment testing. SOP 03-3 provides that previously issued annual financial statements would not need to be restated. Historically, as we have applied the guidance of Practice Bulletin 6, we have moved yields upward and downward as appropriate under that guidance. However, since SOP 03-3 guidance does not permit yields to be lowered, under either the revised Practice Bulletin 6 or SOP 03-3, it will increase the probability of us having to incur impairment charges in the future, which could reduce our profitability in a given period and could negatively impact our stock price.

We incur increased costs as a result of enacted and proposed changes in laws and regulations

Enacted and proposed changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and rules proposed by the SEC and by the NASDAQ Global Stock Market, have resulted in increased costs to us as we implement their requirements. These rules may affect the cost of certain types of insurance, including director and officer liability insurance, or force us to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. The impact of these events could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers. We continue to evaluate and monitor developments with respect to new and proposed rules and cannot predict or estimate the amount of the additional costs we will incur or the timing of such costs.

The future impact on us of Section 404 of the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated thereunder is unclear

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the SEC adopted rules requiring public companies to include a report by management on the company s internal control over financial reporting in our annual reports on Form 10-K. This report is required to contain an assessment by management of the effectiveness of such company s internal controls over financial reporting. In addition, the public accounting firm auditing a public company s financial statements must report on the effectiveness of the company s internal controls over financial reporting. In the future, if we are unable to comply with the requirements of Section 404 in a timely manner, it could result in an adverse reaction in the financial markets due to a loss of confidence in the reliability of our internal controls over financial reporting, which could cause the market price of our common stock to decline and make it more difficult for us to finance our operations.

The market price of our shares of common stock could fluctuate significantly

Wide fluctuations in the trading price or volume of our shares of common stock could be caused by many factors, including factors relating to our company or to investor perception of our company (including changes in financial estimates and recommendations by research analysts), but also factors relating to (or relating to investor perception of) the accounts receivable management industry or the economy in general.

We may not be able to retain, renegotiate or replace our existing credit facility

If we are unable to retain, renegotiate or replace such facility, our growth could be adversely affected, which could negatively impact our business operations and the price of our common stock.

Decreases in collections due to the economic condition in the United States may have an adverse effect on the company s results of operations, revenue and stock price

Due to the economic condition in the United States, possible high interest rates and unemployment and personal bankruptcy filings, the ability of consumers to pay their debts could be adversely affected. This may in turn adversely impact our results of operations, revenue and stock price.

Terrorist attacks, war and threats of attacks and war may adversely impact results of operations, revenue, and stock price

Terrorist attacks, war and the outcome of war and threats of attacks may adversely affect our results of operations, revenue and stock price. Any or all of these occurrences could have a material adverse effect on our results of operations, revenue and stock price.

Failure to comply with government regulation of the collections industry could result in the suspension or termination of our ability to conduct its business

The collections industry is governed by various US federal and state laws and regulations. Many states require us to be a licensed debt collector. The Federal Trade Commission has the authority to investigate consumer complaints against debt collection companies and to recommend enforcement actions and seek monetary penalties. If we fail to comply with applicable laws and regulations, it could result in the suspension, or termination of our ability to conduct collections which would materially adversely affect us. In addition, new federal and state laws or regulations or changes in the ways these rules or laws are interpreted or enforced could limit our activities in the future or significantly increase the cost of compliance.

Our certificate of incorporation, by-laws and Delaware law contain provisions that may prevent or delay a change of control or that may otherwise be in the best interest of our stockholders

Our certificate of incorporation and by-laws contain provisions that may make it more difficult, expensive or otherwise discourage a tender offer or a change in control or takeover attempt by a third-party, even if such a transaction would be beneficial to our stockholders. The existence of these provisions may have a negative impact on the price of our common stock by discouraging third-party investors from purchasing our common stock. In particular, our certificate of incorporation and by-laws include provisions that:

- classify our board of directors into three groups, each of which will serve for staggered three-year terms;

- permit a majority of the stockholders to remove our directors only for cause;

- permit our directors, and not our stockholders, to fill vacancies on our board of directors;

- require stockholders to give us advance notice to nominate candidates for election to our board of directors or to make stockholder proposals at a stockholders meeting;

permit a special meeting of our stockholders be called only by approval of a majority of the directors, the chairman of the board of directors, the chief executive officer, the president or the written request of holders owning at least 30% of our common stock;

permit our board of directors to issue, without approval of our stockholders, preferred stock with such terms as our board of directors may determine;

permit the authorized number of directors to be changed only by a resolution of the board of directors; and

require the vote of the holders of a majority of our voting shares for stockholder amendments to our by-laws.

In addition, we are subject to Section 203 of the Delaware General Corporation Law which provides certain restrictions on business combinations between us and any party acquiring a 15% or greater interest in our voting stock other than in a transaction approved by our board of directors and, in certain cases, by our stockholders. These provisions of our certificate of incorporation and by-laws and Delaware law could delay or prevent a change in control, even if our stockholders support such proposals. Moreover, these provisions could diminish the opportunities for stockholders to participate in certain tender offers, including tender offers at prices above the then-current market value of our common stock, and may also inhibit increases in the trading price of our common stock that could result from takeover attempts or speculation.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our principal executive offices and primary operations facility are located in approximately 100,000 square feet of leased space in three adjacent buildings in Norfolk, Virginia. This site can currently accommodate approximately 900 employees. We own a two-acre parcel of land across from our headquarters which we developed into a parking lot for use by our employees.

We own an approximately 22,000 square foot facility in Hutchinson, Kansas, and contiguous parcels of land which are used primarily for employee parking. The Hutchinson site can currently accommodate approximately 250 employees. In conjunction with a recent expansion, we acquired and remodeled an additional 4,000 square foot building and 35,000 square feet of adjacent land in order to secure parking for the expanded facility. In February 2008, we acquired an additional .25 acres of land in Hutchinson, Kansas, along with three small buildings on the property.

We also lease a facility located in approximately 23,000 square feet of space in Hampton, Virginia which can accommodate approximately 300 employees.

We also lease a 13,500 square-foot call center in Las Vegas, Nevada which can accommodate approximately 150 employees.

We also lease a 15,000 square-foot facility in Birmingham, Alabama which can accommodate approximately 160 employees and approximately 400 square feet of space in Montgomery, Alabama.

We own a 34,000 square foot building and a nine-acre parcel of land in Jackson, Tennessee which can accommodate approximately 400 employees.

We do not consider any specific leased or owned facility to be material to our operations. We believe that equally suitable alternative facilities are available in all areas where we currently do business.

Item 3. Legal Proceedings.

From time to time, we are involved in various legal proceedings which are incidental to the ordinary course of our business. We regularly initiate lawsuits against consumers and are occasionally countersued by them in such actions. Also, consumers occasionally initiate litigation against us, in which they allege that we have violated a state or federal law in the process of collecting on an account. We do not believe that these routine matters represent a substantial volume of our accounts or that, individually or in the aggregate, they are material to our business or financial condition.

We are not a party to any material legal proceedings and we are unaware of any contemplated material actions against us.

Item 4. Submission of Matters to a Vote of Securityholders.

None.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Price Range of Common Stock

Our common stock (Common Stock) began trading on the NASDAQ Global Stock Market under the symbol PRAA on November 8, 2002. Prior to that time there was no public trading market for our common stock. The following table sets forth the high and low sales price for the Common Stock, as reported by the NASDAQ Global Stock Market, for the periods indicated.

	High	Low
2006		
Quarter ended March 31, 2006	$51.77	$43.89
Quarter ended June 30, 2006	$52.98	$43.91
Quarter ended September 30, 2006	$46.81	$38.23
Quarter ended December 31, 2006	$47.97	$41.11
2007		
Quarter ended March 31, 2007	$49.20	$41.63
Quarter ended June 30, 2007	$62.61	$43.50
Quarter ended September 30, 2007	$65.66	$44.26
Quarter ended December 31, 2007	$54.89	$36.28

As of January 31, 2008, there were 28 holders of record of the Common Stock. Based on information provided by our transfer agent and registrar, we believe that there are 30,875 beneficial owners of the Common Stock.

Stock Performance

The following graph compares, from November 8, 2002, the date of the Company s initial public offering, to December 31, 2007, the cumulative stockholder returns assuming an initial investment of $100 on November 8, 2002 in the Company s Common Stock, the stocks comprising the NASDAQ Global Market Composite Index, the NASDAQ Market Index (U.S.) and the stocks comprising a peer group index consisting of six peers.

	Nov. 8, 2002	Dec. 31, 2002	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2007
PRAA	$ 100	$ 118	$ 172	$ 267	$ 301	$ 302	$ 262
NASDAQ Global Market Composite Index	$ 100	$ 98	$ 147	$ 160	$ 162	$ 178	$ 185
NASDAQ Market Index (U.S.)	$ 100	$ 101	$ 153	$ 167	$ 173	$ 194	$ 213
Peer Group Index	$ 100	$ 108	$ 161	$ 182	$ 227	$ 222	$ 208

The comparisons of stock performance shown above are not intended to forecast or be indicative of possible future performance of the Company s common stock. The Company does not make or endorse any predictions as to its future stock performance.

Equity Incentives

The table below provides information with respect to securities authorized for issuance under our equity compensation plans as of December 31, 2007:

Plan Category	**Number of Securities Authorized for Issuance Under the Plan**	**Number of Securities to be Issued Upon Exercise of Outstanding Options or Nonvested Shares Under the Plan**	**Weighted-average Exercise Price of Outstanding Options and Nonvested Shares(1)**	**Remaining Available for Future Issuance Under the Equity Compensation Plan(2)**
Equity Compensation plans approved by security holders	2,000,000	380,344	$ 7.28	916,255
Equity Compensation plans not approved by security holders	None	None	N/A	None
Total	2,000,000	380,344	$ 7.28	916,255

(1) Includes grants of nonvested shares, for which there is no exercise price, but with respect to which shares are

awarded without cost when the restrictions have been realized. Excluding the impact of the nonvested shares, the weighted average exercise price of outstanding options, warrants and rights is $16.97.

(2) Excludes 703,401 exercised options and vested shares, which are not available for re-issuance.

Dividend Policy

Our board of directors sets our dividend policy. We do not currently pay regular dividends on our Common Stock; however, our board of directors may determine in the future to declare or pay dividends on our Common Stock. On April 23, 2007, the Company s Board of Directors authorized a special one-time cash dividend of $1.00 per share with a record date of May 9, 2007. The cash dividends were paid on June 8, 2007 and totaled $16,069,694. Any future determination as to the declaration and payment of dividends will be at the discretion of our board of directors and will depend on then existing conditions, including our financial condition, results of operations, contractual restrictions, capital requirements, business prospects and other factors that our board of directors may consider relevant.

Item 6. Selected Financial Data.

The following selected financial data should be read in conjunction with the audited consolidated financial statements.

	Years Ended December 31,				
	2007	2006	2005	2004	2003
(Dollars in thousands, except per share data)					
INCOME STATEMENT DATA:					
Revenues:					
Income recognized on finance receivables, net	$ 184,705	$ 163,357	$ 134,674	$ 106,254	$ 81,796
Commissions	36,043	24,965	13,851	7,142	3,131
Total revenues	220,748	188,322	148,525	113,396	84,927
Operating expenses:					
Compensation and employee services	69,021	58,142	44,332	36,620	28,987
Outside legal and other fees and services	47,474	40,139	29,965	21,408	14,147
Communications	8,531	5,876	4,424	3,638	2,772
Rent and occupancy	3,106	2,276	2,101	1,745	1,189
Other operating expenses	5,915	4,758	3,424	2,712	1,932
Depreciation and amortization	5,517	5,131	4,679	2,383	1,445
Total operating expenses	139,564	116,322	88,925	68,506	50,472
Income from operations	81,184	72,000	59,600	44,890	34,455
Net interest income/(expenses)	(3,285)	206	331	(51)	(542)
Income before income taxes	77,899	72,206	59,931	44,839	33,913
Provision for income taxes	29,658	27,716	23,159	17,388	13,199
Net income	$ 48,241	$ 44,490	$ 36,772	$ 27,451	$ 20,714
Net income per share					
Basic	$ 3.08	$ 2.80	$ 2.35	$ 1.79	$ 1.42
Diluted	$ 3.06	$ 2.77	$ 2.28	$ 1.73	$ 1.32
Weighted average shares					
Basic	15,646	15,911	15,642	15,357	14,546
Diluted	15,779	16,082	16,149	15,853	15,712
OPERATING AND OTHER FINANCIAL DATA:					
Cash collections and commissions (1)	$ 298,209	$ 261,357	$ 205,226	$ 160,546	$ 120,183
Operating expenses to cash collections and commissions	47%	45%	43%	43%	42%
Return on equity (2)	20%	20%	21%	20%	20%
Acquisitions of finance receivables, at cost (3)	$ 263,809	$ 112,406	$ 149,645	$ 61,165	$ 61,815
Acquisitions of finance receivables, at face value	$11,113,830	$7,788,158	$5,307,918	$3,340,434	$2,229,682

Employees at period end:					
Total employees	1,677	1,291	1,110	948	798
Ratio of collection personnel to total employees (4)	88%	88%	88%	89%	90%

(1) Includes both cash collected on finance receivables and commission fees received during the relevant period.

(2) Calculated by dividing net income for each year by average monthly stockholders equity for the same year.

(3) Represents cash paid for finance receivables. It does not include certain capitalized costs or purchase price refunded by the seller due to the return of non-compliant accounts (also defined as buybacks). Non-compliant refers to the contractual representations and warranties provided for in the purchase and sale contract between the seller and us. These representations

and warranties from the sellers generally cover account holders death or bankruptcy and accounts settled or disputed prior to sale. The seller can replace or repurchase these accounts.

(4) Includes all collectors and all first-line collection supervisors at December 31.

Below is listed certain key balance sheet data for the periods presented:

	As of December 31,				
(Dollars in thousands)	**2007**	**2006**	**2005**	**2004**	**2003**
BALANCE SHEET DATA:					
Cash and cash equivalents	$ 16,730	$ 25,101	$ 15,985	$ 24,513	$ 24,912
Investments				23,950	
Finance receivables, net	410,297	226,447	193,645	105,189	92,569
Total assets	476,307	293,378	247,772	175,176	126,394
Long-term debt		690	1,152	1,924	1,657
Total debt, including obligations under capital lease and line of credit	168,103	932	16,535	2,501	2,208
Total stockholders equity	235,280	247,278	195,322	151,389	119,148

Below is listed the quarterly consolidated income statements for the years ended December 31, 2007 and 2006:

	For the Quarter Ended							
ollars in thousands, except per share data)	**Dec. 31, 2007**	**Sept. 30, 2007**	**June 30, 2007**	**Mar. 31, 2007**	**Dec. 31, 2006**	**Sept. 30, 2006**	**June 30, 2006**	**Mar. 3 2006**
COME STATEMENT DATA:								
venues:								
come recognized on finance receivables, net	$ 46,741	$ 46,111	$ 46,387	$ 45,466	$ 41,830	$ 41,760	$ 40,394	$ 39,37
mmissions	10,584	8,529	8,389	8,542	7,129	6,076	5,791	5,96
tal revenues	57,325	54,640	54,776	54,008	48,959	47,836	46,185	45,34
erating expenses:								
mpensation and employee services	18,584	17,322	16,681	16,435	15,160	14,550	14,335	14,09
tside legal and other fees and services	12,944	11,847	11,246	11,437	10,757	10,582	9,740	9,06
mmunications	2,603	2,039	2,005	1,884	1,483	1,475	1,304	1,61
nt and occupancy	888	819	739	659	583	573	560	56
her operating expenses	1,449	1,605	1,478	1,383	1,264	1,212	1,205	1,07
preciation and amortization	1,405	1,455	1,362	1,295	1,360	1,279	1,239	1,25
tal operating expenses	37,873	35,087	33,511	33,093	30,607	29,671	28,383	27,66
come from operations	19,452	19,553	21,265	20,915	18,352	18,165	17,802	17,68
t interest income (expense)	(2,106)	(1,073)	(218)	112	100	105	96	(9
come before income taxes	17,346	18,480	21,047	21,027	18,452	18,270	17,898	17,58
ovision for income taxes	6,668	6,787	8,058	8,146	7,038	7,027	6,795	6,85
t income	$ 10,678	$ 11,693	$ 12,989	$ 12,881	$ 11,414	$ 11,243	$ 11,103	$ 10,73
t income per share								
sic	$ 0.71	$ 0.76	$ 0.81	$ 0.81	$ 0.72	$ 0.71	$ 0.70	$ 0.6
luted	$ 0.70	$ 0.75	$ 0.80	$ 0.80	$ 0.71	$ 0.70	$ 0.69	$ 0.6
eighted average shares								
sic	15,136	15,451	16,005	15,993	15,960	15,915	15,897	15,87
luted	15,230	15,777	16,168	16,140	16,106	16,071	16,085	16,06

low is listed the quarterly consolidated balance sheets for the years ended December 31, 2007 and 2006:

	Quarter Ended							
ollars in thousands)	**Dec. 31, 2007**	**Sept. 30, 2007**	**June 30, 2007**	**Mar. 31, 2007**	**Dec. 31, 2006**	**Sept. 30, 2006**	**June 30, 2006**	**Mar. 3 2006**
LANCE SHEET DATA:								
sets								
sh and cash equivalents	$ 16,730	$ 14,464	$ 15,042	$ 27,883	$ 25,101	$ 26,662	$ 25,205	$ 23,35

nance receivables, net	410,297	326,476	288,648	243,568	226,447	211,763	197,438	189,84
operty and equipment, net	16,171	15,217	13,510	12,201	11,193	7,730	7,289	7,56
come taxes receivable	3,022	2,621	2,424		1,513	662		
odwill	18,620	18,620	18,287	18,288	18,287	18,287	18,287	18,28
angible assets, net	5,046	5,399	5,773	6,263	6,754	7,321	7,888	8,45
her assets	6,422	4,435	4,354	4,614	4,083	2,845	3,009	3,74
tal assets	$476,308	$387,232	$348,038	$312,817	$293,378	$275,270	$259,116	$251,25
abilities and Stockholders Equity								
abilities								
counts payable	$ 4,055	$ 2,815	$ 2,456	$ 4,220	$ 2,891	$ 2,763	$ 1,536	$ 3,62
crued expenses	4,471	3,614	3,477	3,063	2,579	2,639	4,420	4,51
come taxes payable				1,765			929	5,00
crued payroll and bonuses	6,820	6,445	4,327	4,203	6,245	6,091	4,039	3,65
ferred tax liability	57,579	51,018	43,970	37,849	33,453	28,971	25,119	23,37
ne of credit	168,000	100,000	38,000					
ng-term debt			19	572	690	807	922	1,03
oligations under capital lease	103	138	174	208	242	276	310	34
tal liabilities	241,028	164,030	92,423	51,880	46,100	41,547	37,275	41,56
ockholders equity								
mmon stock	152	151	160	160	160	159	159	15
ditional paid in capital	71,443	70,044	114,142	116,383	115,528	113,387	112,749	111,70
tained earnings	163,685	153,007	141,313	144,394	131,590	120,177	108,933	97,83
tal stockholders equity	235,280	223,202	255,615	260,937	247,278	233,723	221,841	209,69
tal liabilities and stockholders equity	$476,308	$387,232	$348,038	$312,817	$293,378	$275,270	$259,116	$251,25

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Results of Operations

The following table sets forth certain operating data in dollars and as a percentage of total revenues for the years ended December 31, 2007, 2006 and 2005:

	2007		2006		2005	
Revenues:						
Income recognized on finance receivables, net	$184,704,891	83.7%	$163,357,323	86.7%	$134,674,344	90.7%
Commissions	36,043,320	16.3	24,964,444	13.3	13,850,805	9.3
Total revenues	220,748,211	100.0	188,321,767	100.0	148,525,149	100.0
Operating expenses:						
Compensation and employee services	69,022,177	31.3	58,141,684	30.9	44,332,298	29.8
Outside legal and other fees and services	47,473,920	21.5	40,139,272	21.3	29,964,999	20.2
Communications	8,530,651	3.9	5,875,815	3.1	4,424,080	3.0
Rent and occupancy	3,105,601	1.4	2,276,140	1.2	2,100,914	1.4
Other operating expenses	5,914,580	2.6	4,758,157	2.6	3,423,791	2.3
Depreciation and amortization	5,517,090	2.5	5,130,628	2.7	4,678,598	3.2
Total operating expenses	139,564,019	63.2	116,321,696	61.8	88,924,680	59.9
Income from operations	81,184,192	36.8	72,000,071	38.2	59,600,469	40.1
Interest income	419,284	0.2	584,092	0.3	611,490	0.4
Interest expense	(3,704,263)	(1.7)	(378,546)	(0.2)	(280,503)	(0.2)
Income before income taxes	77,899,213	35.3	72,205,617	38.3	59,931,456	40.4
Provision for income taxes	29,658,015	13.4	27,715,801	14.7	23,159,461	15.6
Net income	$ 48,241,198	21.9%	$ 44,489,816	23.6%	$ 36,771,995	24.8%

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Revenues

Total revenues were $220.7 million for the year ended December 31, 2007, an increase of $32.4 million or 17.2% compared to total revenues of $188.3 million for the year ended December 31, 2006.

Income Recognized on Finance Receivables, net

Income recognized on finance receivables, net was $184.7 million for the year ended December 31, 2007, an increase of $21.3 million or 13.0% compared to $163.4 million for the year ended December 31, 2006. The majority of the increase was due to an increase in our cash collections on our owned defaulted consumer receivables to $262.2 million from $236.4 million, an increase of $25.8 million or 10.9%. Our amortization rate on owned portfolios for the year ended December 31, 2007 was 29.6% while for the year ended December 31, 2006 it was 30.9%. During the year ended December 31, 2007, we acquired defaulted consumer receivables portfolios with an aggregate face value amount of $11.1 billion at an original purchase price of $263.8 million. During the year ended December 31, 2006, we acquired defaulted consumer receivable portfolios with an aggregate face value of $7.8 billion at an original purchase price of $112.4 million. In any period, we acquire defaulted consumer receivables that can vary dramatically in their age, type and ultimate collectibility. We may pay significantly different purchase rates for purchased receivables within any period as a result of this quality fluctuation. As a result, the average purchase rate paid for any given period can fluctuate dramatically based on our particular buying activity in that period. However, regardless of the average purchase price, we intend to target a similar internal rate of return (after direct expenses) in pricing our portfolio acquisitions; therefore, the absolute rate paid is not necessarily relevant to estimated profitability of a period s buying.

Income recognized on finance receivables is shown net of changes in valuation allowances recognized under SOP 03-3, which requires that a valuation allowance be taken for decreases in expected cash flows or change in timing of cash flows which would otherwise require a reduction in the stated yield on a pool of accounts. For the years ended December 31, 2007 and 2006, we recorded net allowance charges of $2.9 million and $1.1 million, respectively.

Commissions

Commissions were $36.0 million for the year ended December 31, 2007, an increase of $11.0 million or 44.0% compared to commissions of $25.0 million for the year ended December 31, 2006. Commissions grew as a result of increases in revenue generated by our IGS fee-for-service business and RDS government processing and collection business offset by a decrease in our ARM contingent fee business compared to the prior year period.

Operating Expenses

Total operating expenses were $139.6 million for the year ended December 31, 2007, an increase of $23.3 million or 20.0% compared to total operating expenses of $116.3 million for the year ended December 31, 2006. Total operating expenses were 46.8% of cash receipts for the year ended December 31, 2007 compared with 44.5% for the same period in 2006.

Compensation and Employee Services

Compensation and employee services expenses were $69.0 million for the year ended December 31, 2007, an increase of $10.9 million or 18.8% compared to compensation and employee services expenses of $58.1 million for the year ended December 31, 2006. Compensation and employee services expenses increased as total employees grew from 1,291 at December 31, 2006 to 1,677 at December 31, 2007, primarily to accommodate our owned portfolio purchasing growth. Additionally, existing employees received normal salary increases. Compensation and employee services expenses as a percentage of cash receipts increased to 23.2% for the year ended December 31, 2007 from 22.3% of cash receipts for the same period in 2006, mainly due to a significant increase in employee staffing, especially in our newer Jackson, Tennessee call center, with a corresponding decrease in collector productivity caused mostly by the addition of this less tenured collection staff.

Outside Legal and Other Fees and Services

Outside legal and other fees and services expenses were $47.5 million for the year ended December 31, 2007, an increase of $7.4 million or 18.5% compared to outside legal and other fees and services expenses of $40.1 million for the year ended December 31, 2006. Of the $7.4 million increase, $0.4 million was attributable to increases in outside fees and services, $4.6 million was attributable to increases in agency fees mainly incurred by our IGS subsidiary, and $0.2 million was attributable to increases in credit bureau fees. This was offset by a $0.1 million decrease in corporate legal expenses. Legal fees and costs increased from $28.4 million for the year ended December 31, 2006 to $30.7 million, an increase of $2.3 million or 8.1%, when compared to the same period in 2007. This increase was attributable to the increased cash collections resulting from the increased number of accounts referred to independent contingent fee attorneys. This increase is consistent with the growth we experienced in our portfolio of defaulted consumer receivables and a portfolio management strategy implemented in mid-2002. This strategy resulted in us referring to the legal suit process more unsuccessfully liquidated accounts that have an identified means of repayment but that are nearing their legal statute of limitations, than had been referred historically. Legal cash collections represented 32.0% of total cash collections for the year ended December 31, 2007, compared to 32.2% for the year ended December 31, 2006. Total legal expenses for the year ended December 31, 2007 were 36.6% of legal cash collections compared to 37.4% for the year ended December 31, 2006.

Communications

Communications expenses were $8.5 million for the year ended December 31, 2007, an increase of $2.6 million or 44.1% compared to communications expenses of $5.9 million for the year ended December 31, 2006. The increase was attributable to growth in mailings and higher telephone expenses incurred to collect on a greater number of defaulted consumer receivables owned and serviced as well as the addition of our new call center in Jackson, Tennessee. Mailings were responsible for 53.8% or $1.4 million of this increase, while the remaining 46.2% or $1.2 million was attributable to increased call volumes.

Rent and Occupancy

Rent and occupancy expenses were $3.1 million for the year ended December 31, 2007, an increase of $0.8 million or 34.8% compared to rent and occupancy expenses of $2.3 million for the year ended December 31, 2006. The increase was primarily due to the addition of our new RDS facility, the addition of our new Norfolk, Virginia administrative and executive facility as well as increased utility charges. Of the $0.8 million increase in 2007, the new RDS location accounted for $123,000 of the increase, the new Norfolk, Virginia administrative and executive facility accounted for $391,000 of the increase and utility and other occupancy charges accounted for $233,000 of the increase. In addition, there was an increase of $83,000 in storage and other facility charges.

Other Operating Expenses

Other operating expenses were $5.9 million for the year ended December 31, 2007, an increase of $1.2 million or 22.9% compared to other operating expenses of $4.8 million for the year ended December 31, 2006. The increase was due to increases in travel and meals, miscellaneous expenses, repairs and maintenance, taxes (non-income), fees and licenses and other expenses. Travel and meals increased by $317,000, miscellaneous expenses increased by $465,000, repairs and maintenance increased by $114,000, taxes (non-income), fees and licenses increased by $231,000 and other expenses increased by $30,000.

Depreciation and Amortization

Depreciation and amortization expenses were $5.5 million for the year ended December 31, 2007, an increase of $0.4 million or 7.8% compared to depreciation and amortization expenses of $5.1 million for the year ended December 31, 2006. The increase is mainly due to capital purchases for our new call center in Jackson, Tennessee, as well as capital purchases for the addition of our new RDS facility, our new administrative and executive facility in Norfolk, Virginia and our expanded call center in Hutchinson, Kansas. These increases were offset by a decrease in the amortization expense on intangible assets of $0.4 million for the year ended December 31, 2007, when compared to the prior year period.

Interest Income

Interest income was $419,000 for the year ended December 31, 2007, a decrease of $165,000 or 28.3% compared to interest income of $584,000 for the year ended December 31, 2006. This decrease is the result of lower average invested cash and cash equivalents balances during the year ended December 31, 2007 compared to the same period in 2006.

Interest Expense

Interest expense was $3,704,000 for the year ended December 31, 2007, an increase of $3,325,000 compared to interest expense of $379,000 for the year ended December 31, 2006. The increase is mainly due to a significant increase in outstanding borrowings on our lines of credit during the year ended December 31, 2007 compared to the same period in 2006.

Provision for Income Taxes

Income tax expense was $29.7 million for the year ended December 31, 2007, an increase of $2.0 million or 7.2% compared to income tax expense of $27.7 million for the year ended December 31, 2006. The increase is mainly due to a 7.9% increase in pre-tax income, up from $72.2 million in 2006, to $77.9 million in 2007, offset by a slight reduction in the effective tax rate from 38.4% for year ended December 31, 2006 versus 38.1% for the year ended December 31, 2007. The lower effective tax rate was due mainly to state tax credits.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Revenues

Total revenues were $188.3 million for the year ended December 31, 2006, an increase of $39.8 million or 26.8% compared to total revenues of $148.5 million for the year ended December 31, 2005.

Income Recognized on Finance Receivables, net

Income recognized on finance receivables, net was $163.4 million for the year ended December 31, 2006, an increase of $28.7 million or 21.3% compared to $134.7 million for the year ended December 31, 2005. The majority of the increase was due to an increase in our cash collections on our owned defaulted consumer receivables to $236.4 million from $191.4 million, an increase of $45.0 million or 23.5%. Our amortization rate on owned portfolios for the year ended December 31, 2006 was 30.9% while for the year ended December 31, 2005 it was 29.6%. During the year ended December 31, 2006, we acquired defaulted consumer receivables portfolios with an aggregate face value amount of $7.8 billion at an original purchase price of $112.4 million. During the year ended December 31, 2005, we acquired defaulted consumer receivable portfolios with an aggregate face value of $5.3 billion at an original purchase price of $149.6 million. In any period, we acquire defaulted consumer receivables that can vary dramatically in their age, type and ultimate collectibility. We may pay significantly different purchase rates for purchased receivables within any period as a result of this quality fluctuation. As a result, the average purchase rate paid for any given period can fluctuate dramatically based on our particular buying activity in that period. However, regardless of the average purchase price, we intend to target a similar internal rate of return (after direct expenses) in pricing our portfolio acquisitions; therefore, the absolute rate paid is not necessarily relevant to estimated profitability of a period s buying.

Income recognized on finance receivables is shown net of changes in valuation allowances recognized under SOP 03-3, which requires that a valuation allowance be taken for decreases in expected cash flows. For the year ended December 31, 2006 and 2005 we booked net allowance charges of $1.1 million and $0.2 million, respectively.

Commissions

Commissions were $25.0 million for the year ended December 31, 2006, an increase of $11.1 million or 79.9% compared to commissions of $13.9 million for the year ended December 31, 2005. Commissions increased as a result of the addition of our RDS government processing and collection business in the third quarter of 2005 as well as increases in revenue in both our IGS fee-for-service business and our ARM contingent fee business compared to the prior year period.

Operating Expenses

Total operating expenses were $116.3 million for the year ended December 31, 2006, an increase of $27.4 million or 30.8% compared to total operating expenses of $88.9 million for the year ended December 31, 2005. Total operating expenses were 44.5% of cash receipts for the year ended December 31, 2006 compared with 43.3% for the same period in 2005.

Compensation and Employee Services

Compensation and employee services expenses were $58.1 million for the year ended December 31, 2006, an increase of $13.8 million or 31.2% compared to compensation and employee services expenses of $44.3 million for the year ended December 31, 2005. Compensation and employee services expenses increased as total employees grew from 1,110 at December 31, 2005 to 1,291 at December 31, 2006. Additionally, existing employees received normal salary increases. Compensation and employee services expenses as a percentage of cash receipts excluding sales increased to 22.3% for the year ended December 31, 2006 from 21.6% of cash receipts excluding sales for the same period in 2005 as a result of increased collector headcount as well as increases in salaries related to the hiring of non-collection personnel including several key new employees in our information technology department.

Outside Legal and Other Fees and Services

Outside legal and other fees and services expenses were $40.1 million for the year ended December 31, 2006, an increase of $10.1 million or 33.7% compared to outside legal and other fees and services expenses of $30.0 million for the year ended December 31, 2005. Of the $10.1 million increase, $1.0 million was attributable to increases in outside fees and services, $1.8 million was attributable to increases in agency fees mainly incurred by our IGS subsidiary, $0.5 million was attributable to increases in credit bureau fees and $0.7 million was attributable in increases in corporate legal expenses which included legal fees incurred as a result of the investigation requested by the audit committee that occurred during the third quarter of 2006. The remaining $6.1 million of the increase was attributable to the increased cash collections resulting from the increased number of accounts referred to independent contingent fee attorneys. This increase is consistent with the growth we experienced in our portfolio of defaulted consumer receivables and a portfolio management strategy implemented in mid-2002. This strategy resulted in us referring to the legal suit process more unsuccessfully liquidated accounts that have an identified means of repayment but that are nearing their legal statute of limitations, than had been referred historically. Legal cash collections represented 32.2% of total cash collections for the year ended December 31, 2006, compared to 33.1% for the year ended December 31, 2005. Total legal expenses for the year ended December 31, 2006 were 37.4% of legal cash collections compared to 35.1% for the year ended December 31, 2005.

Communications

Communications expenses were $5.9 million for the year ended December 31, 2006, an increase of $1.5 million or 34.1% compared to communications expenses of $4.4 million for the year ended December 31, 2005. The increase was attributable to growth in mailings and higher telephone expenses incurred to collect on a greater number of defaulted consumer receivables owned and serviced. Mailings were responsible for 80.0% or $1.2 million of this increase, while the remaining 20.0% or $0.3 million was attributable to higher phone charges.

Rent and Occupancy

Rent and occupancy expenses were $2.3 million for the year ended December 31, 2006, an increase of $175,000 or 8.3% compared to rent and occupancy expenses of $2.1 million for the year ended December 31, 2005. The increases were mainly attributable to the commencement of our RDS business, the opening of our new IGS location which opened in April 2005 and higher utility and other occupancy charges generally. Of the $175,000 increase in 2006, the new RDS location accounted for $89,000 of the increase, the new IGS space accounted for $42,000 of the increase and utility and other occupancy charges accounted for $64,000 of the increase. This was partially offset by a $20,000 decrease in storage and other facility charges.

Other Operating Expenses

Other operating expenses were $4.8 million for the year ended December 31, 2006, an increase of $1.4 million or 41.2% compared to other operating expenses of $3.4 million for the year ended December 31, 2005. The increase was due to increases in travel and meals, miscellaneous expenses, hiring expenses, repairs and maintenance, taxes fees and licenses and other expenses. Travel and meals increased by $456,000, miscellaneous expenses increased by $368,000, hiring expenses increased by $226,000, repairs and maintenance increased by $148,000, taxes, fees and licenses increased by $111,000 and other expenses increased by $82,000.

Depreciation and Amortization

Depreciation and amortization expenses were $5.1 million for the year ended December 31, 2006, an increase of $0.4 million or 8.5% compared to depreciation and amortization expenses of $4.7 million for the year ended December 31, 2005. The increase was attributable to expenditures for the RDS expansion and the new Jackson, Tennessee facility in 2006, as well as continued capital expenditures on equipment, software and computers related to our growth and systems upgrades.

Interest Income

Interest income was $584,000 for the year ended December 31, 2006, a decrease of $27,000 or 4.4% compared to interest income of $611,000 for the year ended December 31, 2005. This decrease is the result of the investment of larger balances in higher yielding auction rate certificates and tax exempt money market accounts in 2005 than in 2006.

Interest Expense

Interest expense was $379,000 for the year ended December 31, 2006, an increase of $98,000 or 34.9% compared to interest expense of $281,000 for the year ended December 31, 2005. The increase is due to a higher unused line fee under the new revolving credit arrangement offset by a decrease due to lower balances on our long-term debt and obligations under capital leases.

Provision for Income Taxes

Income tax expense was $27.7 million for the year ended December 31, 2006, an increase of $4.5 million or 19.4% compared to income tax expense of $23.2 million for the year ended December 31, 2005. The increase is mainly due to a 20.5% increase in pre-tax income, up from $59.9 million in 2005, to $72.2 million in 2006, offset by a slight reduction in the effective tax rate from 38.6% for year ended December 31, 2005 versus 38.4% for the year ended December 31, 2006. The lower effective tax rate was due mainly to state tax credits.

Supplemental Performance Data

Owned Portfolio Performance:

The following tables show certain data related to our owned portfolio. These tables describe the purchase price, cash collections and related multiples. Further, these tables disclose our entire portfolio, the portfolio of purchased bankrupt accounts only and our entire portfolio less the impact of our purchased bankrupt accounts. The accounts represented in the purchased bankruptcy tables are those accounts that were bankrupt at the time of purchase. This contrasts with accounts that file bankruptcy after we purchase them.

($ in thousands)

Entire Portfolio

Purchase Period	Purchase Price(1)	Unamortized Purchase Price Balance at December 31, 2007(2)	Percentage of Purchase Price Remaining Unamortized at December 31, 2007(3)	Actual Cash Collections Including Cash Sales	Estimated Remaining Collections(4)	Total Estimated Collections(5)	Total Estimated Collections to Purchase Price(6)
1996	$ 3,080	$ 0	0%	$ 9,815	$ 33	$ 9,848	320%
1997	$ 7,685	$ 0	0%	$ 24,339	$ 119	$ 24,458	318%
1998	$ 11,089	$ 0	0%	$ 35,219	$ 336	$ 35,555	321%
1999	$ 18,898	$ 0	0%	$ 63,165	$ 933	$ 64,098	339%
2000	$ 25,020	$ 0	0%	$ 101,251	$ 5,003	$ 106,254	425%
2001	$ 33,479	$ 398	1%	$ 150,788	$ 8,963	$ 159,751	477%
2002	$ 42,324	$ 0	0%	$ 160,838	$ 8,940	$ 169,778	401%
2003	$ 61,456	$ 4,594	7%	$ 201,077	$ 29,548	$ 230,625	375%
2004	$ 59,309	$ 8,755	15%	$ 135,675	$ 44,132	$ 179,807	303%
2005	$ 143,249	$ 70,279	49%	$ 163,974	$ 156,074	$ 320,048	223%
2006	$ 107,854	$ 76,471	71%	$ 76,162	$ 155,444	$ 231,606	215%
2007	$ 263.277	$ 249,799	95%	$ 42,262	$ 493,040	$ 535,302	203%

Purchased Bankruptcy only Portfolio

Purchase Period	Purchase Price(1)	Unamortized Purchase Price Balance at December 31, 2007(2)	Percentage of Purchase Price Remaining Unamortized at December 31, 2007(3)	Actual Cash Collections Including Cash Sales	Estimated Remaining Collections(4)	Total Estimated Collections(5)	Total Estimated Collection to Purchase Price(6)
1996	$ 0	$ 0	0%	$ 0	$ 0	$ 0	0%
1997	$ 0	$ 0	0%	$ 0	$ 0	$ 0	0%
1998	$ 0	$ 0	0%	$ 0	$ 0	$ 0	0%
1999	$ 0	$ 0	0%	$ 0	$ 0	$ 0	0%
2000	$ 0	$ 0	0%	$ 0	$ 0	$ 0	0%
2001	$ 0	$ 0	0%	$ 0	$ 0	$ 0	0%
2002	$ 0	$ 0	0%	$ 0	$ 0	$ 0	0%
2003	$ 0	$ 0	0%	$ 0	$ 0	$ 0	0%
2004	$ 7,472	$ 1,726	23%	$ 12,030	$ 3,429	$ 15,459	207%

2005	$29,325	$ 7,895	27%	$ 31,211	$ 12,986	$ 44,197	151%
2006	$17,671	$ 7,457	42%	$ 15,063	$ 13,529	$ 28,592	162%
2007	$81,834	$ 80,620	99%	$ 2,850	$119,830	$ 122,680	150%

Entire Portfolio less Purchased Bankruptcy Portfolio

Purchase Period	Purchase Price(1)	Unamortized Purchase Price Balance at December 31, 2007(2)	Percentage of Purchase Price Remaining Unamortized at December 31, 2007(3)	Actual Cash Collections Including Cash Sales	Estimated Remaining Collections(4)	Total Estimated Collections(5)	Total Estimated Collections to Purchase Price(6)
1996	$ 3,080	$ 0	0%	$ 9,815	$ 33	$ 9,848	320%
1997	$ 7,685	$ 0	0%	$ 24,339	$ 119	$ 24,458	318%
1998	$ 11,089	$ 0	0%	$ 35,219	$ 336	$ 35,555	321%
1999	$ 18,898	$ 0	0%	$ 63,165	$ 933	$ 64,098	339%
2000	$ 25,020	$ 0	0%	$ 101,251	$ 5,003	$ 106,254	425%
2001	$ 33,479	$ 398	1%	$ 150,788	$ 8,963	$ 159,751	477%
2002	$ 42,324	$ 0	0%	$ 160,838	$ 8,940	$ 169,778	401%
2003	$ 61,456	$ 4,594	7%	$ 201,077	$ 29,548	$ 230,625	375%
2004	$ 51,837	$ 7,029	14%	$ 123,645	$ 40,703	$ 164,348	317%
2005	$113,924	$ 62,384	55%	$ 132,763	$143,088	$ 275,851	242%
2006	$ 90,183	$ 69,014	77%	$ 61,099	$141,915	$ 203,014	225%
2007	$181,443	$ 169,179	93%	$ 39,412	$373,210	$ 412,622	227%

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

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

(3) Percentage of purchase price remaining unamortized refers to the amount of unamortized purchase price divided by the purchase price.

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

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

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

The following graph shows the purchase price of our owned portfolios by year beginning in 1996. The purchase price number represents the cash paid to the seller to acquire defaulted consumer receivables, plus certain capitalized costs, less the purchase price refunded by the seller due to the return of non-compliant accounts.

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

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

Cash Collection By Year, By Year of Purchase Entire Portfolio

nds)

urchase Price	Cash Collection Period 1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
3,080	$548	$2,484	$ 1,890	$ 1,348	$ 1,025	$ 730	$ 496	$ 398	$ 285	$ 210	$ 237	$ 102
7,685		2,507	5,215	4,069	3,347	2,630	1,829	1,324	1,022	860	597	437
11,089			3,776	6,807	6,398	5,152	3,948	2,797	2,200	1,811	1,415	882
18,898				5,138	13,069	12,090	9,598	7,336	5,615	4,352	3,032	2,243
25,020					6,894	19,498	19,478	16,628	14,098	10,924	8,067	5,202
33,479						13,048	28,831	28,003	26,717	22,639	16,048	10,011
42,324							15,073	36,258	35,742	32,497	24,729	16,527
61,456								24,308	49,706	52,640	43,728	30,695
59,309									18,019	46,475	40,424	30,750
143,249										18,968	75,145	69,862
107,854											22,971	53,192
263,277												42,263
776,720	$548	$4,991	$10,881	$17,362	$30,733	$53,148	$79,253	$117,052	$153,404	$191,376	$236,393	$262,166

Cash Collection By Year, By Year of Purchase Purchased Bankruptcy only Portfolio

($ in thousands)

Purchase Period	Purchase Price	Cash Collection Period 1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	Total
1996	$	$	$	$	$	$	$	$	$	$	$	$	$	$
1997														$
1998														$
1999														$
2000														$
2001														$
2002														$
2003														$
2004	7,472									743	4,554	3,956	2,222	$11,475
2005	29,325										3,777	15,500	9,504	$28,781
2006	17,671											5,608	7,464	$13,072
2007	81,834												582	$ 582
Total	$136,302	$	$	$	$	$	$	$	$	$743	$8,331	$25,064	$19,772	$53,910

Cash Collection By Year, By Year of Purchase Entire Portfolio less Purchased Bankruptcy Portfolio

nds)

urchase Price	Cash Collection Period 1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007

3,080	$548	$2,484	$ 1,890	$ 1,348	$ 1,025	$ 730	$ 496	$ 398	$ 285	$ 210	$ 237	$ 102
7,685		2,507	5,215	4,069	3,347	2,630	1,829	1,324	1,022	860	597	437
11,089			3,776	6,807	6,398	5,152	3,948	2,797	2,200	1,811	1,415	882
18,898				5,138	13,069	12,090	9,598	7,336	5,615	4,352	3,032	2,243
25,020					6,894	19,498	19,478	16,628	14,098	10,924	8,067	5,202
33,479						13,048	28,831	28,003	26,717	22,639	16,048	10,011
42,324							15,073	36,258	35,742	32,497	24,729	16,527
61,456								24,308	49,706	52,640	43,728	30,695
51,837									17,276	41,921	36,468	28,528
113,924										15,191	59,645	60,358
90,183											17,363	45,728
181,443												41,681
640,418	$548	$4,991	$10,881	$17,362	$30,733	$53,148	$79,253	$117,052	$152,661	$183,045	$211,329	$242,394

When we acquire a new portfolio of finance receivables, our estimates typically result in a 84-96 month projection of cash collections. The following chart shows our historical cash collections (including cash sales of finance receivables) in relation to the aggregate of the total estimated collection projections made at the time of each respective pool purchase.

Owned Portfolio Personnel Performance:

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

Collector by Tenure

Tenure at:	**12/31/03**	**12/31/04**	**12/31/05**	**12/31/06**	**12/31/07**
One year +(1)	241	298	327	340	327
Less than one year (2)	338	349	364	375	553
Total(2)	579	647	691	715	880

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

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

Monthly Cash Collections by Tenure

Effective beginning in the third quarter of 2007, we are no longer able to produce this data. Changes in our collection processes and call flows would create data statistics that would be historically inconsistent.

Cash Collections per Hour Paid (1)

Average performance	**12/31/03**	**12/31/04**	**12/31/05**	**12/31/06**	**12/31/07**
Total cash collections	$ 108.27	$ 117.59	$ 133.39	$ 146.03	$ 135.77
Non-legal cash collections(2)	$ 80.10	$ 82.06	$ 89.25	$ 99.06	$ 91.93
Non-bk cash collections(3)			$ 128.02	$ 132.15	$ 123.10

(1) Cash collections (assigned and unassigned) divided by total hours paid (including holiday,

vacation and sick time) to all collectors (including those in training).

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

(3) Represents total cash collections less bankruptcy cash collections. Although we began bankruptcy portfolio purchasing in 2004, we began calculating this metric in 2005.

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

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

Seasonality

We depend on the ability to collect on our owned and serviced defaulted consumer receivables. Collections tend to be higher in the first and second quarters of the year and lower in the third and fourth quarters of the year, due to consumer payment patterns in connection with seasonal employment trends, income tax refunds and holiday spending habits. Historically, our growth has partially masked the impact of this seasonality.

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

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

Cash Collection Source ($ in thousands)	**Q42007**	**Q32007**	**Q22007**	**Q12007**	**Q42006**	**Q32006**	**Q22006**	**Q12006**
Call Center Collections & Other	$36,994	$37,450	$37,464	$39,241	$32,437	$32,686	$33,736	$36,436
Legal	20,861	21,384	20,911	20,844	19,762	19,607	19,058	17,606
Purchased Bankruptcy	7,245	6,317	6,231	7,223	6,581	7,390	6,645	4,447

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

	2007	**2006**	**2005**
Balance at beginning of year	$ 226,447,495	$ 193,644,670	$ 105,188,906
Acquisitions of finance receivables, net of buybacks (1)	261,310,120	105,838,296	145,157,090
Cash collections applied to principal on finance receivables (2)	(77,461,021)	(73,035,471)	(56,701,326)
Balance at end of year	$ 410,296,594	$ 226,447,495	$ 193,644,670
Estimated Remaining Collections (ERC(3))	$ 902,565,418	$ 553,222,894	$ 492,924,998

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

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

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

Liquidity and Capital Resources

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

We believe that funds generated from operations, together with existing cash and available borrowings under our credit agreement will be sufficient to finance our current operations, planned capital expenditure requirements and internal growth at least through the next twelve months. However, we could require additional debt or equity financing if we were to make any other significant acquisitions requiring cash during that period.

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

Our operating activities provided cash of $80.4 million, $59.5 million and $57.9 million for the years ended December 31, 2007, 2006 and 2005, respectively. In these periods, cash from operations was generated primarily from net income earned through cash collections and commissions received. Net income increased to $48.2 million for the year ended December 31, 2007 from $44.5 million for the year ended December 31, 2006 and $36.8 million for the year ended December 31, 2005. Net cash provided by operating activities was also impacted by the amount of income taxes paid during the period which was \$5.3 million, \$18.8 million and \$9.4 million for the years ended December 31, 2007, 2006 and 2005, respectively. In addition, we realized tax benefits derived from share-based compensation of \$2.2 million in 2005. In 2006, in accordance with the adoption of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment (SFAS 123R) the benefit derived from share-based compensation was reclassified to financing activities. The remaining increase was due to net changes in other accounts related to our operating activities.

Our investing activities used cash of $192.9 million, $39.7 million and $83.0 million for the years ended December 31, 2007, 2006 and 2005, respectively. The majority of the change was due to acquisitions of finance receivables which increased to $261.3 million for the year ended December 31, 2007 from $105.8 million for the year ended December 31, 2006 and $145.2 million for the year ended December 31, 2005. Cash used in investing activities is primarily driven by acquisitions of defaulted consumer receivables, purchases of property and equipment and purchases of auction rate certificates and variable rate demand notes. In addition, in 2005, we purchased the assets of Alatax, Inc. for $15.0 million in cash including acquisition costs. Cash provided by investing activities is primarily driven by cash collections applied to principal on finance receivables and the sale of auction rate certificates and variable rate demand notes.

Our financing activities provided cash of $104.2 million in 2007, used cash of $10.7 million and provided cash of $16.6 million for the years ended December 31, 2006 and 2005, respectively. The majority of the change was due to proceeds received from debt financing from our lines of credit partially offset by cash used to pay a cash dividend on our common stock and the repurchase of 1,000,000 shares of our common stock during the year ended December 31, 2007. Cash is provided by proceeds from debt financing and stock option exercises. Also, in accordance with the adoption of SFAS 123R on January 1, 2006, the benefit derived from share-based compensation was $1.6 million and $2.4 million in 2007 and 2006, respectively. This was previously classified in operating activities. In addition, the exercise of stock options and stock warrants generated cash from financing activities of $2.1 million for the year ended December 31, 2007, $2.5 million for the year ended December 31, 2006 and $2.6 million for the year ended December 31, 2005. Cash used in financing activities is primarily driven by payments on our lines of credit, dividends paid, repurchases of common stock and principal payments on long-term debt and capital lease obligations.

Cash paid for interest expense was approximately $2,779,000, $411,000 and $281,000 for the years ended December 31, 2007, 2006 and 2005, respectively. The majority of interest expenses were paid on our lines of credit, capital lease obligations and other long-term debt.

On November 29, 2005, we entered into a Loan and Security Agreement for a revolving line of credit jointly offered by Bank of America, N. A. and Wachovia Bank, National Association. The agreement was amended on May 9, 2006 to include RBC Centura Bank as an additional lender, again on May 4, 2007 to increase the line of credit to $150,000,000 and incorporate a $50,000,000 non-revolving sub-limit and again on October 26, 2007 to increase the line of credit to $270,000,000. The agreement is a revolving line of credit in an amount equal to the lesser of $270,000,000 or 30% of the Company s estimated remaining collections of all of our eligible asset pools. Borrowings under the revolving credit facility bear interest at a floating rate equal to the LIBOR Market Index Rate plus 1.40% and the facility expires on May 4, 2010. The loan is collateralized by substantially all of our tangible and intangible assets. The agreement provides as follows:

- restrictions on monthly borrowings are limited to 30% of Estimated Remaining Collections;
- a funded debt to EBITDA ratio of less than 2.0 to 1.0 calculated on a rolling twelve-month average;
- tangible net worth of at least 100% of prior quarter tangible net worth plus 25% of cumulative positive net income since the end of such fiscal quarter, plus 100% of the net proceeds from any equity offering without giving effect to reductions in tangible net worth due to repurchases of up to $100,000,000 of our common stock; and
- restrictions on change of control.

Outstanding borrowings under the facility totaled $168,000,000 as of December 31, 2007, of which $50,000,000 was part of the non-revolving fixed rate sub-limit which bears interest at 6.80% and expires on May 4, 2012. As of December 31, 2007, we are in compliance with all of the covenants of the agreement.

Contractual Obligations

The following summarizes our contractual obligations that exist as of December 31, 2007:

		Payments due by period			
Contractual Obligations	**Total**	**Less than 1 year**	**1 - 3 years**	**4 - 5 years**	**More than 5 years**
Operating Leases	$ 17,446,395	$ 2,529,151	$ 5,143,859	$ 4,446,150	$ 5,327,235
Long-Term Debt and Line of Credit (1)	184,362,447	4,623,114	125,206,000	54,533,333	
Capital Lease Obligations	105,647	99,949	5,698		
Purchase Commitments (2)	19,960,275	18,992,557	866,932	100,786	
Employment Agreements	6,179,089	4,853,580	1,325,509		
Total	$ 228,053,853	$ 31,098,351	$ 132,547,998	$ 59,080,269	$ 5,327,235

(1) To the extent that a balance is outstanding on our lines of credit, the revolving portion would be due in May, 2010 and the non-revolving fixed rate sub-limit portion would be due in May, 2012.

(2) This amount includes the maximum remaining amount to be purchased under forward flow contracts for the purchase of charged-off consumer debt in the amount of approximately $16.5 million.

Off Balance Sheet Arrangements

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

Recent Accounting Pronouncements

On September 15, 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. The changes to current practice resulting from the application of SFAS 157 relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. SFAS 157 was originally effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years but was amended on February 6, 2008 to defer the effective date for one year for certain non financial assets and liabilities. We are currently evaluating the impact SFAS 157 will have on our financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 is effective for fiscal years beginning after November 15, 2007. SFAS 159 allows entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item s fair value in subsequent reporting periods must be recognized in current earnings. SFAS 159 also establishes presentation and disclosure requirements designed to draw comparison between entities that elect different measurement attributes for similar assets and liabilities. We are currently evaluating the impact SFAS 159 will have on our consolidated financial statements.

In December 2007, the FASB issued Business Combinations, (SFAS 141R). SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination, recognizing assets acquired and liabilities assumed arising from contingencies, and determining what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for fiscal years beginning after December 15, 2008. We expect SFAS 141R will have an impact on our consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions we consummate after the effective date. We are currently evaluating what impact SFAS 141R will have on our consolidated financial statements.

Critical Accounting Policies

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

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

Revenue Recognition

We acquire accounts that have experienced deterioration of credit quality between origination and our acquisition of the accounts. The amount paid for an account reflects our determination that it is probable we will be unable to collect all amounts due according to the account s contractual terms. At acquisition, we review each account to determine whether there is evidence of deterioration of credit quality since origination and if it is probable that we will be unable to collect all amounts due according to the account s contractual terms. If both conditions exist, we determine whether each such account is to be accounted for individually or whether such accounts will be assembled into pools based on common risk characteristics. We consider expected prepayments and estimate the amount and timing of undiscounted expected principal, interest and other cash flows for each acquired portfolio and subsequently aggregated pools of accounts. We determine the excess of the pool s scheduled contractual principal and contractual interest payments over all cash flows expected at acquisition as an amount that should not be accreted (nonaccretable difference) based on our proprietary acquisition models. The remaining amount, representing the excess of the account s cash flows expected to be collected over the amount paid, is accreted into income recognized on finance receivables over the remaining life of the account or pool (accretable yield).

Prior to January 1, 2005, we accounted for our investment in finance receivables using the interest method under the guidance of Practice Bulletin 6, Amortization of Discounts on Certain Acquired Loans. Effective January 1, 2005, we adopted and began to account for our investment in finance receivables using the interest method under the guidance of AICPA SOP 03-3, Accounting for Loans or Certain Securities Acquired in a Transfer. For loans acquired in fiscal years beginning prior to December 15, 2004, Practice Bulletin 6 is still effective; however, Practice Bulletin 6 was amended by SOP 03-3 as described further in this note. For loans acquired in fiscal years beginning after December 15, 2004, SOP 03-3 is effective. Under the guidance of SOP 03-3 (and the amended Practice Bulletin 6), static pools of accounts may be established. These pools are aggregated based on certain common risk criteria. Each static pool is recorded at cost, which includes certain direct costs of acquisition paid to third parties, and is accounted for as a single unit for the recognition of income, principal payments and loss provision. Once a static pool is established for a quarter, individual receivable accounts are not added to the pool (unless replaced by the seller) or removed from the pool (unless sold or returned to the seller). SOP 03-3 (and the amended Practice Bulletin 6) requires that the excess of the contractual cash flows over expected cash flows not be recognized as an adjustment of revenue or expense or on the balance sheet. SOP 03-3 initially freezes the internal rate of return, referred to as IRR, estimated when the accounts receivable are purchased as the basis for subsequent impairment testing. Significant increases in expected future cash flows may be recognized prospectively through an upward adjustment of the IRR over a portfolio s remaining life. Any increase to the IRR then becomes the new benchmark for impairment testing. Effective for fiscal years beginning after December 15, 2004 under SOP 03-3 and the amended Practice Bulletin 6, rather than lowering the estimated IRR if the collection estimates are not received, the carrying value of a pool would be written down to maintain the then current IRR and is recorded as a reduction in revenue in the consolidated income statements with a corresponding valuation allowance offsetting the finance receivables, net, on the consolidated balance sheets. Income on finance receivables is accrued quarterly based on each static pool s effective IRR. Quarterly cash flows greater than the interest accrual will reduce the carrying value of the static pool. Likewise, cash flows that are less than the accrual will accrete the carrying balance. We generally do not allow accretion in the first six to twelve months. The IRR is estimated and periodically recalculated based on the timing and amount of anticipated cash flows using our proprietary collection models. A pool can become fully amortized (zero carrying balance on the balance sheet) while still generating cash collections. In this case, all cash collections are recognized as revenue when received. Additionally, we use the cost recovery method when collections on a particular pool of accounts cannot be reasonably predicted. These pools are not aggregated with other portfolios. Under the cost recovery method, no revenue is recognized until we have fully collected the cost of the portfolio, or until such time that we consider the collections to be probable and estimable and begin to recognize income based on the interest method as described above.

We establish valuation allowances for all acquired accounts subject to SOP 03-3 to reflect only those losses incurred after acquisition (that is, the present value of cash flows initially expected at acquisition that are no longer expected to be collected). Valuation allowances are established only subsequent to acquisition of the accounts. At December 31, 2007 and 2006, we had a $4,230,000 and $1,300,000 valuation allowance on our finance receivables, respectively. Prior to January 1, 2005, in the event that a reduction of the yield to as low as zero in conjunction with estimated future cash collections that were inadequate to amortize the carrying balance, an allowance charge would be taken with a corresponding write-off of the receivable balance.

We utilize the provisions of Emerging Issues Task Force 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent (EITF 99-19) to commission revenue from our contingent fee, skip-tracing and government processing and collection subsidiaries. EITF 99-19 requires an analysis to be completed to determine if certain revenues should be reported gross or reported net of their related operating expense. This analysis includes an assessment of who retains inventory/credit risk, who controls vendor selection, who establishes pricing and who remains the primary obligor on the transaction. Each of these factors was considered to determine the correct method of recognizing revenue from our subsidiaries.

For our contingent fee subsidiary, the portfolios which are placed for servicing are owned by our clients and are placed under a contingent fee commission arrangement. Our subsidiary is paid to collect funds from the client s debtors and earns a commission generally expressed as a percentage of the gross collection amount. The Commissions line of our income statement reflects the contingent fee amount earned, and not the gross collection amount.

Our skip tracing subsidiary utilizes gross reporting under EITF 99-19. We generate revenue by working an account and successfully locating a customer for our client. An investigative fee is received for these services. In addition, we incur agent expenses where we hire a third-party collector to effectuate repossession. In many cases we have an arrangement with our client which allows us to bill the client for these fees. We have determined these fees to be gross revenue based on the criteria in EITF 99-19 and they are recorded as such in the line item Commissions, primarily because we are primarily liable to the third party collector. There is a corresponding expense in Outside legal and other fees and services for these pass-through items.

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

We account for our gain on cash sales of finance receivables under SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Gains on sale of finance receivables, representing the difference between the sales price and the unamortized value of the finance receivables sold, are recognized when finance receivables are sold.

We apply a financial components approach that focuses on control when accounting and reporting for transfers and servicing of financial assets and extinguishments of liabilities. Under that approach, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, eliminates financial assets when control has been surrendered, and eliminates liabilities when extinguished. This approach provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings.

Valuation of Acquired Intangibles and Goodwill

In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, we are required to perform a review of goodwill for impairment annually or earlier if indicators of potential impairment exist. The review of goodwill for potential impairment is highly subjective and requires that: (1) goodwill is allocated to various reporting units of our business to which it relates; and (2) we estimate the fair value of those reporting units to which the goodwill relates and then determine the book value of those reporting units. If the estimated fair value of reporting units with allocated goodwill is determined to be less than their book value, we are required to estimate the fair value of all identifiable assets and liabilities of those reporting units in a manner similar to a purchase price allocation for an acquired business. This requires independent valuation of certain unrecognized assets. Once this process is complete, the amount of goodwill impairment, if any, can be determined.

We believe that, as of December 31, 2007, there was no impairment of goodwill or other intangible assets. However, changes in various circumstances including changes in our market capitalization, changes in our forecasts and changes in our internal business structure could cause one of our reporting units to be valued differently thereby causing an impairment of goodwill. Additionally, in response to changes in our industry and changes in global or regional economic conditions, we may strategically realign our resources and consider restructuring, disposing or otherwise exiting businesses, which could result in an impairment of some or all of our identifiable intangibles or goodwill.

Income Taxes

We record a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with SFAS No. 109, Accounting for Income Taxes, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carry-forwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. Beginning with the adoption of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) as of January 1, 2007, we recognize the effect of the income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgement occurs.

Effective with our 2002 tax filings, we adopted the cost recovery method of income recognition for tax purposes. We believe cost recovery to be an acceptable method for companies in the bad debt purchasing industry and results in the reduction of current taxable income as, for tax purposes, collections on finance receivables are applied first to principal to reduce the finance receivables to zero before any income is recognized.

We believe it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the deferred tax assets. In the event that all or part of the deferred tax assets are determined not to be realizable in the future, a valuation allowance would be established and charged to earnings in the period such determination is made. Similarly, if we subsequently realize deferred tax assets that were previously determined to be unrealizable, the respective valuation allowance would be reversed, resulting in a positive adjustment to earnings or a decrease in goodwill in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with our expectations could have a material impact on our results of operations and financial position.

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Item 7A. Quantitative and Qualitative Disclosure About Market Risk.

Our exposure to market risk relates to interest rate risk with our variable rate credit line. The average borrowings on our variable rate credit line were $30.2 million for the year ended December 31, 2007. Assuming a 200 basis point increase in interest rates, interest expense would have increased by $0.6 million for the year ended December 31, 2007. As of December 31, 2007, we had $118 million of variable rate debt outstanding on our credit lines. We do not have any other variable rate debt outstanding as of December 31, 2007. Significant increases in future interest rates on the variable rate credit line could lead to a material decrease in future earnings assuming all other factors remained constant.

Item 8. Financial Statements and Supplementary Data.
Index to Financial Statements

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Portfolio Recovery Associates, Inc.:

We have audited Portfolio Recovery Associates, Inc. s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Portfolio Recovery Associates, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control Over Financial Reporting (Item 9A). Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Portfolio Recovery Associates, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Portfolio Recovery Associates, Inc. and subsidiaries (the Company) as of December 31, 2007, and the related consolidated income statement, and statements of changes in stockholders equity, and cash flows for the year then ended, and our report dated February 28, 2008 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Norfolk, Virginia
February 28, 2008

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Portfolio Recovery Associates, Inc.:

We have audited the accompanying consolidated balance sheet of Portfolio Recovery Associates, Inc. and subsidiaries (the Company) as of December 31, 2007, and the related consolidated income statement, and statements of changes in stockholders equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Portfolio Recovery Associates, Inc. and subsidiaries as of December 31, 2007, and the results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

As discussed in note 2 to the consolidated financial statements, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*, effective January 1, 2007.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Portfolio Recovery Associates, Inc. s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 28, 2008 expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ KPMG LLP

Norfolk, Virginia
February 28, 2008

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Portfolio Recovery Associates, Inc.:

In our opinion, the consolidated balance sheet as of December 31, 2006 and the related consolidated statements of income, stockholders equity, and cash flows for each of two years in the period ended December 31, 2006 present fairly, in all material respects, the financial position of Portfolio Recovery Associates, Inc. and its subsidiaries at December 31, 2006 and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

McLean, Virginia
March 1, 2007

Portfolio Recovery Associates, Inc.
Consolidated Balance Sheets
December 31, 2007 and 2006

	2007	2006
Assets		
Cash and cash equivalents	$ 16,729,918	$ 25,100,834
Finance receivables, net	410,296,594	226,447,495
Property and equipment, net	16,171,346	11,192,974
Income taxes receivable	3,022,208	1,512,823
Goodwill	18,620,277	18,287,511
Intangible assets, net	5,045,610	6,754,014
Other assets	6,421,537	4,082,780
Total assets	$ 476,307,490	$ 293,378,431
Liabilities and Stockholders Equity		
Liabilities:		
Accounts payable	$ 4,055,025	$ 2,891,469
Accrued expenses	4,471,573	2,578,896
Accrued payroll and bonuses	6,819,612	6,244,852
Deferred tax liability	57,578,782	33,452,670
Line of credit	168,000,000	
Long-term debt		689,892
Obligations under capital lease	102,835	242,385
Total liabilities	241,027,827	46,100,164
Commitments and contingencies (Note 16)		
Stockholders equity:		
Preferred stock, par value $0.01, authorized shares, 2,000,000, issued and outstanding shares - 0		
Common stock, par value $0.01, authorized shares, 30,000,000, issued and outstanding shares - 15,159,056 at December 31, 2007, and 15,987,432 at December 31, 2006	151,591	159,874
Additional paid-in capital	71,443,150	115,527,975
Retained earnings	163,684,922	131,590,418
Total stockholders equity	235,279,663	247,278,267
Total liabilities and stockholders equity	$ 476,307,490	$ 293,378,431

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

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Portfolio Recovery Associates, Inc.
Consolidated Income Statements
For the years ended December 31, 2007, 2006 and 2005

	2007	2006	2005
Revenues:			
Income recognized on finance receivables, net	$ 184,704,891	$ 163,357,323	$ 134,674,344
Commissions	36,043,320	24,964,444	13,850,805
Total revenues	220,748,211	188,321,767	148,525,149
Operating expenses:			
Compensation and employee services	69,022,177	58,141,684	44,332,298
Outside legal and other fees and services	47,473,920	40,139,272	29,964,999
Communications	8,530,651	5,875,815	4,424,080
Rent and occupancy	3,105,601	2,276,140	2,100,914
Other operating expenses	5,914,580	4,758,157	3,423,791
Depreciation and amortization	5,517,090	5,130,628	4,678,598
Total operating expenses	139,564,019	116,321,696	88,924,680
Income from operations	81,184,192	72,000,071	59,600,469
Other income and (expense):			
Interest income	419,284	584,092	611,490
Interest expense	(3,704,263)	(378,546)	(280,503)
Income before income taxes	77,899,213	72,205,617	59,931,456
Provision for income taxes	29,658,015	27,715,801	23,159,461
Net income	$ 48,241,198	$ 44,489,816	$ 36,771,995
Net income per common share			
Basic	$ 3.08	$ 2.80	$ 2.35
Diluted	$ 3.06	$ 2.77	$ 2.28
Weighted average number of shares outstanding			
Basic	15,646,370	15,910,795	15,641,862
Diluted	15,778,691	16,081,798	16,148,703

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

Portfolio Recovery Associates, Inc.
Consolidated Statements of Changes in Stockholders Equity
For the years ended December 31, 2007, 2006 and 2005

	Common Stock	Additional Paid-in Capital	Retained Earnings	Total Stockholders Equity
Balance at December 31, 2004	$ 154,982	$ 100,905,851	$ 50,328,607	$ 151,389,440
Net income			36,771,995	36,771,995
Exercise of stock options, warrants and vesting of nonvested shares	2,355	3,001,532		3,003,887
Issuance of common stock for acquisition	337	1,443,426		1,443,763
Amortization of share-based compensation		520,845		520,845
Income tax benefit from share-based compensation		2,192,245		2,192,245
Balance at December 31, 2005	$ 157,674	$ 108,063,899	$ 87,100,602	$ 195,322,175
Net income			44,489,816	44,489,816
Exercise of stock options, warrants and vesting of nonvested shares	2,200	2,500,425		2,502,625
Amortization of share-based compensation		2,116,631		2,116,631
SFAS123R adoption reclass of payroll liability to additional paid-in capital		426,752		426,752
Income tax benefit from share-based compensation		2,420,268		2,420,268
Balance at December 31, 2006	$ 159,874	$ 115,527,975	$ 131,590,418	$ 247,278,267
Net income			48,241,198	48,241,198
Exercise of stock options and vesting of nonvested shares	1,709	2,072,533		2,074,242
Issuance of common stock for acquisition	8	49,992		50,000
Repurchase and cancellation of common stock	(10,000)	(50,546,924)		(50,556,924)
Cash dividends paid ($1.00 per common share)			(16,069,694)	(16,069,694)
Amortization of share-based compensation		2,575,253		2,575,253
Income tax benefit from share-based compensation		1,574,321		1,574,321
Adoption of FIN 48		190,000	(77,000)	113,000
Balance at December 31, 2007	$ 151,591	$ 71,443,150	$ 163,684,922	$ 235,279,663

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

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Portfolio Recovery Associates, Inc.
Consolidated Statements of Cash Flows
For the years ended December 31, 2007, 2006 and 2005

	2007	2006	2005
Cash flows from operating activities:			
Net income	$ 48,241,198	$ 44,489,816	$ 36,771,995
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of share-based compensation	2,575,253	2,116,631	967,281
Income tax benefit from share-based compensation			2,192,245
Depreciation and amortization	5,517,090	5,130,628	4,678,598
Deferred tax expense	24,126,112	11,106,675	8,695,272
Changes in operating assets and liabilities:			
Other assets	(2,338,757)	(436,654)	(215,371)
Accounts payable	1,163,556	558,784	(92,241)
Income taxes	(1,319,385)	(4,567,706)	2,872,662
Accrued expenses	1,815,677	339,629	517,233
Accrued payroll and bonuses	574,760	728,986	1,466,699
Net cash provided by operating activities	80,355,504	59,466,789	57,854,373
Cash flows from investing activities:			
Purchases of property and equipment	(8,661,058)	(6,868,532)	(3,484,415)
Acquisition of finance receivables, net of buybacks	(261,310,119)	(105,838,296)	(145,157,090)
Collections applied to principal on finance receivables	77,461,020	73,035,471	56,701,326
Purchases of auction rate certificates		(1,450,000)	(105,725,000)
Sales of auction rate certificates		1,450,000	129,675,000
Acquisitions, including acquisition costs and net of cash acquired	(408,766)		(14,983,332)
Net cash used in investing activities	(192,918,923)	(39,671,357)	(82,973,511)
Cash flows from financing activities:			
Dividends paid	(16,069,694)		
Proceeds from exercise of options and warrants	2,074,242	2,502,625	2,557,451
Income tax benefit from share-based compensation	1,574,321	2,420,268	
Draws on line of credit	171,000,000		15,000,000
Principal payments on line of credit	(3,000,000)	(15,000,000)	
Repurchases of common stock	(50,556,924)		
Principal payments on long-term debt	(689,892)	(462,073)	(772,457)
Principal payments on capital lease obligations	(139,550)	(140,273)	(193,576)
Net cash provided by/(used in) financing activities	104,192,503	(10,679,453)	16,591,418

Net (decrease)/increase in cash and cash equivalents		(8,370,916)		9,115,979		(8,527,720)
Cash and cash equivalents, beginning of year		25,100,834		15,984,855		24,512,575
Cash and cash equivalents, end of year	$	16,729,918	$	25,100,834	$	15,984,855
Supplemental disclosure of cash flow information:						
Cash paid for interest	$	2,778,774	$	411,376	$	280,503
Cash paid for income taxes	$	5,288,725	$	18,763,763	$	9,399,281
Noncash investing and financing activities:						
SFAS123R adoption reclass of payroll liability to additional paid-in capital	$		$	426,752	$	
Acquisitions Common stock issued	$	50,000	$		$	1,443,763

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

Portfolio Recovery Associates, Inc.
Notes to Consolidated Financial Statements

1. Organization and Business:

Portfolio Recovery Associates, LLC (PRA) was formed on March 20, 1996. Portfolio Recovery Associates, Inc. (PRA Inc) was formed in August 2002. On November 8, 2002, PRA Inc completed its initial public offering (IPO) of common stock. As a result, all of the membership units and warrants of PRA were exchanged on a one to one basis for warrants and shares of a single class of common stock of PRA Inc. One of PRA Inc s wholly owned subsidiaries, Thomas West Associates, LLC (TWA), was dissolved as an entity on May 8, 2006. Another subsidiary, PRA II, was dissolved immediately prior to the IPO. PRA Inc, a Delaware corporation, and its subsidiaries (collectively, the Company) are full-service providers of outsourced receivables management and related services. The Company is engaged in the business of purchasing, managing and collecting portfolios of defaulted consumer receivables as well as offering a broad range of accounts receivable management services. The majority of the Company s business activities involve the purchase, management and collection of defaulted consumer receivables. These are purchased from sellers of finance receivables and collected by a highly skilled staff whose purpose is to locate and contact customers and arrange payment or resolution of their debts. The Company, through its Legal Recovery Department, collects accounts judicially, either by using its own attorneys, or by contracting with independent attorneys throughout the country through whom the Company takes legal action to satisfy consumer debts. The Company also services receivables on behalf of clients on either a commission or transaction-fee basis. Clients include entities in the financial services, auto, retail, utility, health care and government sectors. Services provided to these clients include standard collection services on delinquent accounts, obtaining location information for clients in support of their collection activities (known as skip tracing), and the management of both delinquent and non-delinquent tax receivables for government entities.

On December 28, 1999, PRA formed a wholly owned subsidiary, PRA Holding I, LLC (PRA Holding I), and is the sole member. The purpose of PRA Holding I is to enter into leases of office space and hold the Company s real property (see Note 10) in Hutchinson, Kansas, Norfolk, Virginia and other real and personal property.

On June 1, 2000, PRA formed a wholly owned subsidiary, PRA Receivables Management, LLC (d/b/a Anchor Receivables Management) (Anchor) and was the sole initial member. Anchor is organized as a contingent collection agency and contracts with holders of finance receivables to attempt collection efforts on a contingent basis for a stated period of time. Anchor became fully operational during April 2001. PRA Inc purchased the equity interest in Anchor from PRA immediately after the IPO.

On October 1, 2004, the Company acquired the assets of IGS Nevada, Inc., a privately held company specializing in asset-location and debt resolution services (the resulting business is referred to herein as IGS). The transaction was completed at a price of $14 million, consisting of $12 million in cash and $2 million in PRA Inc common stock. On September 10, 2004, the Company created a wholly owned subsidiary, PRA Location Services, LLC d/b/a IGS Nevada to operate IGS. IGS Nevada, Inc. s founder and his top management team signed long-term employment agreements and continue to manage IGS.

On July 29, 2005, the Company acquired substantially all of the assets and liabilities of Alatax, Inc., a provider of outsourced business revenue administration, audit and debt discovery/recovery services for local governments (the resulting business is referred to herein as RDS). The transaction was completed for consideration of $17.5 million, consisting of $16.1 million in cash and 33,684 shares of the Company s common stock, valued at $1.4 million at the closing in accordance with the calculation set forth in the asset purchase agreement. Alatax Inc. s two top executives both signed long-term employment agreements and continue to manage the company. Although most of its clients are located in Alabama (where it operates as Alatax), RDS, through PRA Government Services, LLC, a wholly owned subsidiary formed by the Company on June 23, 2005, began expanding into surrounding states (where it operates as Revenue Discovery Systems (RDS)). The accompanying consolidated income statements include the results of operations of RDS for the period from August 1, 2005 through December 31, 2007.

PRA Funding, LLC and PRA III were merged into PRA on November 24, 2003.

On October 13, 2006, PRA formed a wholly owned subsidiary, PRA Holding II, LLC (PRA Holding II), and is the sole member. The purpose of PRA Holding II is to hold the Company s real property in Jackson, Tennessee and other real and personal property.

Portfolio Recovery Associates, Inc.
Notes to Consolidated Financial Statements

On August 8, 2007, PRA formed a wholly owned subsidiary, PRA Bankruptcy Services, LLC (PRA BS) and is the sole member.

2. Summary of Significant Accounting Policies:

Principles of accounting and consolidation: The consolidated financial statements of the Company are prepared in accordance with U.S. generally accepted accounting principles and include the accounts of PRA Inc, PRA, PRA Holding I, PRA Holding II, Anchor, IGS, RDS and PRA BS. All significant intercompany accounts and transactions have been eliminated.

Cash and cash equivalents: The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Included in cash and cash equivalents are funds held on the behalf of others arising from the collection of accounts placed with the Company. The balance of the funds held on behalf of others was $1,263,563 and $435,522 at December 31, 2007 and 2006, respectively. There is an offsetting liability that is included in Accounts payable on the accompanying consolidated balance sheets.

Investments: The Company accounts for its investments under the guidance of the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard (SFAS) No. 115 (SFAS 115), Accounting for Certain Investments in Debt and Equity Securities. The Company typically invests in variable rate auction rate certificates and variable rate demand notes which are classified as available-for-sale securities. At December 31, 2007 and 2006, the Company did not have any investments on the consolidated balance sheets; however, it did purchase investments during 2006.

Concentrations of credit risk: Financial instruments, which potentially expose the Company to concentrations of credit risk, consist primarily of cash and cash equivalents and investments. The Company places its cash and cash equivalents and investments with high quality financial institutions. At times, cash balances may be in excess of the amounts insured by the Federal Deposit Insurance Corporation.

Finance receivables and income recognition: The Company s principal business consists of the acquisition and collection of accounts that have experienced deterioration of credit quality between origination and the Company s acquisition of the accounts. The amount paid for an account reflects the Company s determination that it is probable the Company will be unable to collect all amounts due according to the account s contractual terms. At acquisition, the Company reviews the portfolio both by account and aggregate pool to determine whether there is evidence of deterioration of credit quality since origination and if it is probable that the Company will be unable to collect all amounts due according to the account s contractual terms. If both conditions exist, the Company determines whether each such account is to be accounted for individually or whether such accounts will be assembled into pools based on common risk characteristics. The Company considers expected prepayments and estimates the amount and timing of undiscounted expected principal, interest and other cash flows for each acquired portfolio and subsequently aggregated pools of accounts. The Company determines the excess of the pool s scheduled contractual principal and contractual interest payments over all cash flows expected at acquisition as an amount that should not be accreted (nonaccretable difference) based on the Company s proprietary acquisition models. The remaining amount, representing the excess of the account s cash flows expected to be collected over the amount paid, is accreted into income recognized on finance receivables over the remaining life of the account or pool (accretable yield).

Prior to January 1, 2005, the Company accounted for its investment in finance receivables using the interest method under the guidance of Practice Bulletin 6, Amortization of Discounts on Certain Acquired Loans. Effective January 1, 2005, the Company adopted and began to account for its investment in finance receivables using the interest method under the guidance of American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 03-3, Accounting for Loans or Certain Securities Acquired in a Transfer. For loans acquired in fiscal years beginning prior to December 15, 2004, Practice Bulletin 6 is still effective; however, Practice Bulletin 6 was amended by SOP 03-3 as described further in this note. For loans acquired in fiscal years beginning after December 15, 2004, SOP 03-3 is effective. Under the guidance of SOP 03-3 (and the amended Practice Bulletin 6), static pools of accounts may be established. These pools are aggregated based on certain common risk criteria. Each static pool is recorded at cost, which includes certain direct costs of acquisition paid to third parties, and is accounted for as a single unit for the recognition of income, principal payments and loss provision. Once a static

Portfolio Recovery Associates, Inc.
Notes to Consolidated Financial Statements

pool is established for a quarter, individual receivable accounts are not added to the pool (unless replaced by the seller) or removed from the pool (unless sold or returned to the seller). SOP 03-3 (and the amended Practice Bulletin 6) requires that the excess of the contractual cash flows over expected cash flows not be recognized as an adjustment of revenue or expense or on the balance sheet. SOP 03-3 initially freezes the internal rate of return, referred to as IRR, estimated when the accounts receivable are purchased as the basis for subsequent impairment testing. Significant increases in actual, or expected future cash flows may be recognized prospectively through an upward adjustment of the IRR over a portfolio s remaining life. Any increase to the IRR then becomes the new benchmark for impairment testing. Effective for fiscal years beginning after December 15, 2004 under SOP 03-3 (and the amended Practice Bulletin 6), rather than lowering the estimated IRR if the collection estimates are not received or projected to be received, the carrying value of a pool would be written down to maintain the then current IRR and is recorded as a reduction in revenue in the consolidated income statements with a corresponding valuation allowance offsetting the finance receivables, net, on the consolidated balance sheets. Income on finance receivables is accrued quarterly based on each static pool s effective IRR. Quarterly cash flows greater than the interest accrual will reduce the carrying value of the static pool. Likewise, cash flows that are less than the accrual will accrete the carrying balance. The Company generally does not allow accretion in the first six to twelve months. The IRR is estimated and periodically recalculated based on the timing and amount of anticipated cash flows using the Company s proprietary collection models. A pool can become fully amortized (zero carrying balance on the balance sheet) while still generating cash collections. In this case, all cash collections are recognized as revenue when received. Additionally, the Company uses the cost recovery method when collections on a particular pool of accounts cannot be reasonably predicted. These pools are not aggregated with other portfolios. Under the cost recovery method, no revenue is recognized until the Company has fully collected the cost of the portfolio, or until such time that the Company considers the collections to be probable and estimable and begins to recognize income based on the interest method as described above. At December 31, 2007 and 2006, the Company had unamortized purchased principal (purchase price) in pools accounted for under the cost recovery method of $6,301,373 and $1,611,130, respectively.

The Company establishes valuation allowances for all acquired accounts subject to SOP 03-3 to reflect only those losses incurred after acquisition (that is, the present value of cash flows initially expected at acquisition that are no longer expected to be collected). Valuation allowances are established only subsequent to acquisition of the accounts. At December 31, 2007 and 2006, the Company had an allowance against its finance receivables of $4,230,000 and $1,300,000, respectively. Prior to January 1, 2005, in the event that a reduction of the yield to as low as zero in conjunction with estimated future cash collections that were inadequate to amortize the carrying balance, an allowance charge would be taken with a corresponding write-off of the receivable balance.

The Company capitalizes certain fees paid to third parties related to the direct acquisition of a portfolio of accounts. These fees are added to the acquisition cost of the portfolio and accordingly are amortized over the life of the portfolio using the interest method. The balance of the unamortized capitalized fees at December 31, 2007, 2006 and 2005 was $2,434,916, $1,322,721 and $1,028,401, respectively. During the years ended December 31, 2007, 2006 and 2005 the Company capitalized $1,683,951, $805,640 and $502,556, respectively, of these direct acquisition fees. During the years ended December 31, 2007, 2006 and 2005 the Company amortized $571,756, $511,320 and $573,002, respectively, of these direct acquisition fees.

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

Commissions: The Company utilizes the provisions of Emerging Issues Task Force 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent (EITF 99-19) to record commission revenue from its contingent fee, skip-tracing and government processing and collection subsidiaries. EITF 99-19 requires an analysis to be completed to determine if certain revenues should be reported gross or reported net of their related operating expense. This analysis includes who retains inventory/credit risk, who controls vendor selection, who establishes

Portfolio Recovery Associates, Inc.
Notes to Consolidated Financial Statements

pricing and who remains the primary obligor on the transaction. The Company considers each of these factors to determine the correct method of recognizing revenue from its subsidiaries.

For the Company s contingent fee collection subsidiary, the portfolios that are placed for servicing are owned by its clients and are placed under a contingent fee commission arrangement. The Company s subsidiary is paid to collect funds from the client s debtors and earns a commission generally expressed as a percentage of the gross collection amount. The Commissions line of the income statement reflects the contingent fee amount earned, and not the gross collection amount.

The Company s skip tracing subsidiary utilizes gross reporting under EITF 99-19. IGS generates revenue by working an account and successfully locating a customer for their client. An investigative fee is received for these services. In addition, the Company incurs agent expenses where it hires a third-party collector to effectuate repossession. In many cases the Company has an arrangement with its client which allows it to bill the client for these fees. The Company has determined these fees to be gross revenue based on the criteria in EITF 99-19 and they are recorded as such in the line item Commissions, primarily because the Company is primarily liable to the third party collector. There is a corresponding expense in Outside Legal and Other Fees and Services for these pass-through items.

The Company s government processing and collection subsidiary utilizes both gross and net reporting under EITF 99-19. RDS s primary source of income is derived from servicing taxing authorities in several different ways: processing all of their tax payments and tax forms, collecting delinquent taxes, identifying taxes that are not being paid and auditing tax payments. The processing and collection pieces are standard commission based billings or fee for service transactions and are included in the line item Commissions. When RDS conducts an audit, there are two components. The first is a charge for the hours incurred on conducting the audit. This charge is for hours worked and includes a profit margin above our actual cost. The gross billing is a component of the line item Commissions and the expense is included in the line item Compensation and employee services. The second item is for expenses incurred while conducting the audit. Most jurisdictions will reimburse RDS for direct expenses incurred for the audit including such items as travel and meals. The billed amounts are included in the line item Commissions and the expense component is included in their appropriate expense category, generally the line item Other operating expenses.

Property and equipment: Property and equipment, including improvements that significantly add to the productive capacity or extend useful life, are recorded at cost, while maintenance and repairs are expensed currently. Property and equipment are depreciated over their useful lives using the straight-line method of depreciation. Software and computer equipment is amortized or depreciated over three to five years. Furniture and fixtures are depreciated over five years. Equipment is depreciated over five to seven years. Leasehold improvements aredepreciated over the lesser of the useful life, which ranges from three to ten years, or the remaining life of the leased property. Building improvements are depreciated over ten to thirty-nine years. When property is sold or retired, the cost and related accumulated depreciation are removed from the balance sheet and any gain or loss is included in the income statement.

Intangible assets: The Company adopted SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142) on October 1, 2004. Prior to this date, the Company had no assets in this category. With the acquisition of IGS on October 1, 2004, RDS on July 29, 2005 and The Palmer Group on July 27, 2007, the Company purchased certain tangible and intangible assets. Intangible assets purchased included client and customer relationships, non-compete agreements and goodwill. In accordance with SFAS 142, the Company is amortizing the IGS client relationships over seven years, the RDS customer relationships over ten years, The Palmer Group customer relationships over three years and the non-compete agreements over three years for both the IGS and RDS acquisitions. The Company reviews them at least annually for impairment. In addition, goodwill, pursuant to SFAS 142, is not amortized but rather reviewed annually for impairment.

Income taxes: The Company records a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with SFAS No. 109, Accounting for Income Taxes, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carry-forwards. Deferred tax assets and liabilities are measured

Portfolio Recovery Associates, Inc.
Notes to Consolidated Financial Statements

using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. Beginning with the adoption of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) as of January 1, 2007, the Company recognizes the effect of the income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

Effective with the Company s 2002 tax filings, the Company adopted the cost recovery method of income recognition for tax purposes. The Company believes cost recovery to be an acceptable tax revenue recognition method for companies in the bad debt purchasing industry and results in the reduction of current taxable income as, for tax purposes, collections on finance receivables are applied first to principal to reduce the finance receivables to zero before any income is recognized.

The Company believes that it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the deferred tax assets. In the event that all or part of the deferred tax assets are determined not to be realizable in the future, a valuation allowance would be established and charged to earnings in the period such determination is made. Similarly, if the Company subsequently realizes deferred tax assets that were previously determined to be unrealizable, the respective valuation allowance would be reversed, resulting in a positive adjustment to earnings or a decrease in goodwill in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with management s expectations could have a material impact on the Company s results of operations and financial position.

Advertising costs: Advertising costs are expensed when incurred.

Operating leases: General abatements or prepaid leasing costs are recognized on a straight-line basis over the life of the lease. In addition, future minimum lease payments (including the impact of rent escalations) are expensed on a straight-lined basis over the life of the lease. Material leasehold improvements are capitalized and depreciated over the remaining life of the lease.

Capital leases: Leases are analyzed to determine if they meet the definition of a capital lease as defined in SFAS No. 13, Accounting for Leases. Those lease arrangements that meet one of the four criteria are considered capital leases. As such, the leased asset is capitalized and amortized. The lease is recorded as a liability with each payment amortizing the principal balance and a portion classified as interest expense.

Stock-based compensation: The Company applied the intrinsic value method provided for under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, for all warrants issued to employees prior to January 1, 2002. For warrants and options issued to non-employees, the Company followed the fair value method of accounting as prescribed under SFAS No. 123, Accounting for Stock Based Compensation (SFAS 123). On January 1, 2002, the Company adopted SFAS 123 on a prospective basis for all warrants and options granted and reported the change in accounting principle using the retroactive restatement method as prescribed in SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure. Effective January 1, 2006, the Company adopted FASB Statement No. 123R (SFAS 123R), Share-Based Payment using the modified prospective approach.

Use of estimates: The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Portfolio Recovery Associates, Inc.
Notes to Consolidated Financial Statements

Significant estimates have been made by management with respect to the collectibility of future cash flows of finance receivables portfolios. Actual results could differ from these estimates making it reasonably possible that a change in these estimates could occur within one year. On a quarterly basis, management reviews the estimates of future cash collections, and whether it is reasonably possible that its assessments of collectibility may change based on actual results and other factors.

Estimated fair value of financial instruments: The Company applies the provisions of SFAS No. 107, Disclosures About Fair Value of Financial Instruments, to its financial instruments. Its financial instrumentsconsist of cash and cash equivalents, finance receivables, net, line of credit, long-term debt, and obligations under capital leases. See Note 11 for additional disclosure.

Recent Accounting Pronouncements: On September 15, 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. The changes to current practice resulting from the application of SFAS 157 relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. SFAS 157 was originally effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years but was amended on February 6, 2008 to defer the effective date for one year for certain nonfinancial assets and liabilities. The Company is currently evaluating the impact SFAS 157 will have on its financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 is effective for fiscal years beginning after November 15, 2007. SFAS 159 allows entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item s fair value in subsequent reporting periods must be recognized in current earnings. SFAS 159 also establishes presentation and disclosure requirements designed to draw comparison between entities that elect different measurement attributes for similar assets and liabilities. The Company is currently evaluating the impact SFAS 159 will have on its consolidated financial statements.

In December 2007, the FASB issued Business Combinations, (SFAS 141R). SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination, recognizing assets acquired and liabilities assumed arising from contingencies, and determining what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for fiscal years beginning after December 15, 2008. The Company expects SFAS 141R will have an impact on its consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions that the Company consummates after the effective date. The Company is currently evaluating what impact SFAS 141R will have on its consolidated financial statements.

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3. Finance Receivables, net:

As of December 31, 2007 and 2006, the Company had $410,296,594 and $226,447,495, respectively, remaining of finance receivables, net. Changes in finance receivables, net for the years ended December 31, 2007 and 2006, were as follows:

	2007	2006
Balance at beginning of year	$ 226,447,495	$ 193,644,670
Acquisitions of finance receivables, net of buybacks	261,310,119	105,838,296
Cash collections	(262,165,911)	(236,392,794)
Income recognized on finance receivables, net	184,704,891	163,357,323
Cash collections applied to principal	(77,461,020)	(73,035,471)
Balance at end of year	$ 410,296,594	$ 226,447,495

At the time of acquisition, the life of each pool is generally estimated to be between 84 to 96 months based on projected amounts and timing of future cash receipts using the proprietary models of the Company. As of December 31, 2007, the Company had $410,296,594 in finance receivables, net included in the consolidated balance sheet. Based upon current projections, cash collections applied to principal will be as follows for the twelve months in the years ending:

December 31, 2008	$ 89,585,374
December 31, 2009	92,323,177
December 31, 2010	86,881,202
December 31, 2011	71,616,844
December 31, 2012	48,353,016
December 31, 2013	20,847,423
December 31, 2014	689,558
	$ 410,296,594

During the year ended December 31, 2007, the Company purchased $11.1 billion of face value of charged-off consumer receivables. During the year ended December 31, 2006, the Company purchased $7.8 billion of face value of charged-off consumer receivables. At December 31, 2007, the estimated remaining collections on the receivables purchased during 2007 and 2006 were $493,040,394 and $155,444,216, respectively.

Accretable yield represents the amount of income the Company can expect to generate over the remaining life of its existing portfolios based on estimated future cash flows as of December 31, 2007 and 2006. Reclassifications from nonaccretable difference to accretable yield primarily result from the Company s increase in its estimate of future cash flows. Changes in accretable yield for the years ended December 31, 2007 and 2006 were as follows:

	2007	2006
Balance at beginning of year	$ 326,775,399	$ 299,280,328
Income recognized on finance receivables, net	(184,704,891)	(163,357,323)
Additions	279,725,421	128,771,384
Reclassifications from nonaccretable difference	70,472,895	62,081,010

Balance at end of year	$ 492,268,824	$ 326,775,399

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During the years ended December 31, 2007, 2006 and 2005, the Company recorded a $3,210,000, $1,100,000 and $200,000 allowance charge, respectively, on portfolios that had underperformed expectations. During the year ended December 31, 2007, the Company also reversed $280,000 of allowance charges recorded in prior periods. The changes in the valuation allowance for the years ended December 31, 2007, 2006 and 2005 are as follows:

	2007	2006	2005
Balance at beginning of year	$ 1,300,000	$ 200,000	$
Allowance charges recorded	3,210,000	1,100,000	200,000
Reversal of previously recorded allowance charges	(280,000)		
Change in allowance charge	2,930,000	1,100,000	200,000
Balance at end of year	$ 4,230,000	$ 1,300,000	$ 200,000

4. Operating Leases:

The Company rents office space and equipment under operating leases. Rental expense was $2,511,842, $1,915,103 and $1,803,812 for the years ended December 31, 2007, 2006 and 2005, respectively.

Future minimum lease payments for operating leases at December 31, 2007, are as follows:

2008	$ 2,529,151
2009	2,739,668
2010	2,404,192
2011	2,190,255
2012	2,255,896
Thereafter	5,327,233
	$ 17,446,395

5. Intangible Assets, net:

With the acquisition of IGS on October 1, 2004, RDS on July 29, 2005 and The Palmer Group on July 25, 2007, the Company purchased certain tangible and intangible assets. Intangible assets purchased included client and customer relationships, non-compete agreements and goodwill. In accordance with SFAS No. 142, the Company is amortizing the IGS client relationships over seven years, the RDS customer relationships over ten years and the non-compete agreements over three years for both the IGS and RDS acquisitions, with a combined original weighted average amortization period of 7.49 years. For The Palmer Group acquisition, the Company is amortizing the customer relationship over the remaining life of the contract, which at the date of acquisition was 29 months. The Company reviews these relationships at least annually for impairment. Total amortization expense for the years ended December 31, 2007, 2006 and 2005 was $1,834,404, $2,268,652 and $2,296,172, respectively.

Intangible assets consist of the following at December 31, 2007 and 2006:

	2007	2006
Client and customer relationships	$ 9,926,000	$ 9,800,000
Non-compete agreements	2,000,000	2,000,000
Accumulated amortization	(6,880,390)	(5,045,986)
Intangible assets, net	$ 5,045,610	$ 6,754,014

Amortization expense relating to the non-compete agreements is calculated on a straight-line method (which approximates the pattern of economic benefit concept) for the IGS non-compete agreements and a pattern of economic benefit concept for the Alatax non-compete agreements. Amortization expense relating to the client and customer relationships is calculated using a pattern of economic benefit concept for the IGS and RDS acquisitions and straight-line over the length of the contract for The Palmer Group acquisition. The pattern of economic benefit concept relies on expected net cash flows from all existing clients. The rate of amortization of the client relationships will fluctuate annually to match these expected cash flows.

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The future amortization of these intangible assets is estimated to be as follows as of December 31, 2007:

2008	$ 1,406,216
2009	1,229,419
2010	963,579
2011	696,551
2012	266,841
Thereafter	483,004
	$ 5,045,610

In addition, goodwill, pursuant to SFAS 142, is not amortized but rather is reviewed at least annually for impairment. During the fourth quarter of 2007, the Company underwent its annual review of goodwill. Based upon the results of this review, which was conducted as of October 1, 2007, no impairment charges to goodwill or the other intangible assets were necessary as of the date of this review. The Company believes that nothing has occurred since the review was performed through December 31, 2007, that would necessitate an impairment charge to goodwill or the other intangible assets. At December 31, 2007 and December 31, 2006, the carrying value of goodwill was $18,620,277 and $18,287,511, respectively. The $332,766 increase in the carrying value of goodwill during the year ended December 31, 2007 relates to the acquisition of The Palmer Group on July 25, 2007.

6. Capital Leases:

Leased assets included in property and equipment consists of the following as of December 31, 2007 and 2006:

	2007	**2006**
Software	$ 270,008	$ 270,008
Computer equipment	48,169	56,063
Furniture and fixtures	1,260,287	1,260,287
Equipment	27,249	27,249
Less accumulated depreciation and amortization	(1,413,514)	(1,278,095)
	$ 192,199	$ 335,512

Depreciation and amortization expense recognized on capital leases for the years ended December 31, 2007, 2006 and 2005 was $143,313, $183,904 and $235,164, respectively.

Commitments for minimum lease payments for these capital leases as of December 31, 2007 are as follows:

2008	$ 99,949
2009	5,698
	105,647
Less amount representing interest and taxes	(2,812)
Present value of net minimum lease payments	$ 102,835

7. 401(k) Retirement Plan:

The Company sponsors a defined contribution plan. Under the plan, all employees over twenty-one years of age are eligible to make voluntary contributions to the plan up to 100% of their compensation, subject to Internal Revenue Service limitations after completing six months of service, as defined in the plan. The Company makes matching contributions of up to 4% of an employee s salary. Total compensation expense related to these contributions was $843,387, $682,115 and $603,830 for the years ended December 31, 2007, 2006 and 2005, respectively.

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8. Line of Credit:

On November 29, 2005, the Company entered into a Loan and Security Agreement for a revolving line of credit jointly offered by Bank of America, N. A. and Wachovia Bank, National Association. The agreement was amended on May 9, 2006 to include RBC Centura Bank as an additional lender, again on May 4, 2007 to increase the line of credit to $150,000,000 and incorporate a $50,000,000 non-revolving sub-limit and again on October 26, 2007 to increase the line of credit to $270,000,000. The agreement is a revolving line of credit in an amount equal to the lesser of $270,000,000 or 30% of the Company s estimated remaining collections of all of its eligible asset pools. Borrowings under the revolving credit facility bear interest at a floating rate equal to the LIBOR Market Index Rate plus 1.40% and the facility expires on May 4, 2010. The loan is collateralized by substantially all of our tangible and intangible assets. The agreement provides as follows:

restrictions on monthly borrowings are limited to 30% of estimated remaining collections;

a funded debt to EBITDA ratio of less than 2.0 to 1.0 calculated on a rolling twelve-month average;

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

restrictions on change of control.

Outstanding borrowings under the facility totaled $168,000,000 as of December 31, 2007, of which $50,000,000 was part of the non-revolving fixed rate sub-limit which bears interest at 6.80% and expires on May 4, 2012. As of December 31, 2007, the Company was in compliance with all of the covenants of the agreement.

9. Property and equipment, net:

Property and equipment, at cost, consist of the following as of December 31, 2007 and 2006:

	2007	2006
Software	$ 6,147,377	$ 5,007,449
Computer equipment	6,082,371	4,467,524
Furniture and fixtures	4,758,205	2,716,723
Equipment	4,742,147	3,802,427
Leasehold improvements	2,556,667	1,842,402
Building and improvements	5,123,304	3,282,620
Land	939,264	930,263
Accumulated depreciation and amortization	(14,177,989)	(10,856,434)
Property and equipment, net	$ 16,171,346	$ 11,192,974

Depreciation and amortization expense, relating to property and equipment, for the years ended December 31, 2007, 2006 and 2005 was $3,682,686, $2,861,976 and $2,382,426, respectively.

Beginning in July 2006 upon initiation of certain internally developed software projects, in accordance with the provisions of SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, the Company began capitalizing qualifying computer software costs incurred during the application development stage and amortizing them over their estimated useful life of three years on a straight-line basis beginning when the project is completed. Costs associated with preliminary project stage activities, training, maintenance and all other post implementation stage activities are expensed as incurred. The Company s policy provides for the capitalization of certain direct payroll costs for employees who are directly associated with internal use computer software projects, as well as external direct costs of services associated with developing or obtaining internal use software. Capitalizable personnel costs are limited to the time directly spent on such projects. As of December 31, 2007 and 2006, the Company has incurred and capitalized $524,456 and $165,964, respectively, of these direct payroll costs related to software developed for internal use. As of December 31, 2007 and 2006, of these costs, $98,511 and $99,721, respectively, are for projects that are in the development stage and therefore are a component of Other

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Assets. Once the projects are completed the costs will be transferred to Software and amortized over their estimated useful life of three years. Amortization expense and remaining unamortized costs relating to this internally developed software as of and for the year ended December 31, 2007 were $21,454 and $404,491, respectively. Amortization expense and remaining unamortized costs relating to this internally developed software as of and for the year ended December 31, 2006 were $2,208 and $64,044, respectively.

10. Long-Term Debt:

On February 20, 2002, the Company completed the construction of a satellite parking lot at its Norfolk location. The parking lot was financed with a commercial loan for $500,000 with a fixed rate of 6.47%. The loan was collateralized by the parking lot. The loan required only interest payments during the first six months. Beginning October 1, 2002, monthly payments on the loan were $9,797 and the loan was paid in full at its maturity date of September 1, 2007.

On May 1, 2003, the Company secured financing for its computer equipment purchases related to the Hampton, Virginia office opening. The computer equipment was financed with a commercial loan for $975,000 with a fixed rate of 4.25%. This loan was collateralized by computer equipment. Monthly payments were $18,096 and the loan was paid in full on May 7, 2007.

On January 9, 2004, the Company entered into a commercial loan agreement to finance equipment purchases at one of its leased Norfolk facilities in the amount of $750,000 with a fixed rate of 4.45%. Monthly payments were $13,975 and the loan was paid in full on May 7, 2007.

11. Estimated Fair Value of Financial Instruments:

The accompanying consolidated financial statements include various estimated fair value information as of December 31, 2007 and 2006, as required by SFAS No. 107, Disclosures About Fair Value of Financial Instruments. Disclosure of the estimated fair values of financial instruments often requires the use of estimates. The Company uses the following methods and assumptions to estimate the fair value of financial instruments.

Cash and cash equivalents: The carrying amount approximates fair value.

Finance receivables, net: The Company records purchased receivables at cost, which represents a significant discount from the contractual receivable balances due. The cost of the receivables is reduced as cash is received based upon the guidance of Practice Bulletin 6 and SOP 03-3. The balance as of December 31, 2007 and 2006 was $410,296,594 and $226,447,495, respectively. The Company computed the fair value of these receivables using our proprietary pricing models that the Company utilizes to make portfolio purchase decisions. As of December 31, 2007 and 2006, using the aforementioned methodology, we computed the approximate fair value to be $451,000,000 and $246,000,000, respectively.

Line of credit: The carrying amount approximates fair value.

Long-term debt: The carrying amount approximates fair value.

Obligations under capital lease: The carrying amount approximates fair value.

12. Share-Based Compensation:

The Company has a stock option and nonvested share plan. The Amended and Restated Portfolio Recovery Associates 2002 Stock Option Plan and 2004 Restricted Stock Plan was approved by the Company s shareholders at its Annual Meeting of Shareholders on May 12, 2004, enabling the Company to issue to its employees and directors nonvested shares of stock, as well as stock options.

Effective January 1, 2002, the Company adopted the fair value recognition provisions of SFAS No. 123 (SFAS 123), Accounting for Stock-Based Compensation, prospectively to all employee awards granted, modified, or settled after January 1, 2002. All stock-based compensation measured under the provisions of APB 25 became fully vested during 2002. All stock-based compensation expense recognized thereafter was derived from stock-based

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compensation based on the fair value method prescribed in SFAS 123. Effective January 1, 2006, the Company adopted SFAS No. 123R (SFAS 123R), Share-Based Payment using the modified prospective approach. The adoption of SFAS 123R had no material impact on the Company s Consolidated Income Statement or on previously reported interim periods. As of December 31, 2007, total future compensation costs related to nonvested awards of stock options and nonvested shares (not including nonvested shares granted under the Long-Term Incentive Program) were \$47,220 and \$4,217,783, respectively, with a weighted average remaining life of 2.1 years for stock options and 3.1 years for nonvested shares (not including nonvested shares granted under the Long-Term Incentive Program). Based upon historical data, the Company used an annual forfeiture rate of 13.72% for stock options and between 15%-35% for nonvested shares for most of the employee grants. Grants made to key employee hires and directors of the Company were assumed to have no forfeiture rates associated with them due to the historically low turnover among this group. In addition, commensurate with the adoption of SFAS 123R, all previous references to restricted stock are now referred to as nonvested shares.

Total share-based compensation expense was \$2,575,253, \$2,116,631 and \$1,190,446 for the years ended December 31, 2007, 2006 and 2005, respectively. Tax benefits resulting from tax deductions in excess of share-based compensation expense recognized under the fair value recognition provisions of SFAS 123R (windfall tax benefits) are credited to additional paid-in capital in the Company s Consolidated Balance Sheets. Realized tax shortfalls are first offset against the cumulative balance of windfall tax benefits, if any, and then charged directly to income tax expense. The total tax benefit realized from share-based compensation expense was approximately \$2.4 million, \$3.0 million and \$2.6 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Stock Options

The Company created the 2002 Stock Option Plan on November 7, 2002. The plan was amended in 2004 by the Amended Plan to enable the Company to issue restricted shares of stock to its employees and directors. Up to 2,000,000 shares of common stock may be issued under the Amended Plan. The Amended Plan expires November 7, 2012. All options issued under the Amended Plan vest ratably over five years. Granted options expire seven years from grant date. Expiration dates range between November 7, 2009 and January 16, 2011. Options granted to a single person cannot exceed 200,000 in a single year. As of December 31, 2007, 895,000 options have been granted under the Amended Plan, of which 117,025 have been cancelled and are eligible for regrant. These options are accounted for under SFAS 123R and all expenses for 2007, 2006 and 2005 are included in earnings as a component of compensation and employee services expense.

The following summarizes all option related transactions from December 31, 2004 through December 31, 2007:

	Options Outstanding	Weighted-Average Exercise Price	Weighted-Average Fair Value
December 31, 2004	706,459	\$ 14.65	\$ 2.97
Exercised	(181,910)	13.22	2.73
Cancelled	(20,040)	15.63	2.81
December 31, 2005	504,509	15.12	3.06
Exercised	(188,475)	13.19	2.76
Cancelled	(15,015)	13.00	2.71
December 31, 2006	301,019	16.43	3.27
Exercised	(129,924)	15.97	3.33
Cancelled	(7,855)	13.00	2.71

December 31, 2007	163,240	$	16.97	$	3.25

All of the stock options were issued to employees of the Company except for 40,000 that were issued to non-employee directors. Non-employee directors were granted 20,000 stock options in 2004. No stock options were granted in 2007, 2006 or 2005. The total intrinsic value of options exercised during the years ended December 31, 2007, 2006 and 2005, was approximately $4.1 million, $6.3 million, and $4.7 million, respectively.

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The following information is as of December 31, 2007:

	Options Outstanding				Options Exercisable		
Exercise Prices	Number Outstanding	Average Remaining Contractual Life	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Number Exercisable	Weighted-Average Exercise Price	Aggregate Intrinsic Value
$13.00	114,740	1.9	$ 13.00	$ 3,060,116	114,740	$ 13.00	$ 3,060,116
$16.16	7,500	1.9	16.16	176,325	7,500	16.16	176,325
$27.77 $29.79	41,000	2.7	28.21	469,790	24,000	28.19	275,460
Total as of December 31, 2007	163,240	2.1	$ 16.97	$ 3,706,231	146,240	$ 15.66	$ 3,511,901

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

Nonvested Shares

Prior to the approval of the Amended Plan on May 12, 2004, nonvested shares were issued by the Company as an incentive to attract new employees and, effective May 12, 2004, are being issued pursuant to the Amended Plan to directors and existing employees as well. Generally, nonvested share awards are issued at market value and typically vest ratably over five years. Nonvested share grants are expensed over their vesting period.

The following summarizes all nonvested share transactions from December 31, 2004 through December 31, 2007:

	Nonvested Shares Outstanding	Weighted Average Price at Grant Date
December 31, 2004	89,886	$ 27.06
Granted	74,600	41.92
Vested	(17,389)	27.10
Cancelled	(11,760)	30.40
December 31, 2005	135,337	34.96
Granted	82,700	46.88
Vested	(27,764)	33.88
Cancelled	(19,165)	37.75
December 31, 2006	171,108	40.59
Granted	8,510	43.42
Vested	(40,904)	38.74
Cancelled	(16,060)	38.23
December 31, 2007	122,654	$ 41.72

The total grant date fair value of shares vested during the years ended December 31, 2007, 2006 and 2005, was $1,584,621, $940,644 and $471,241, respectively.

Long-Term Incentive Program

On March 30, 2007, the Compensation Committee approved the grant of 96,550 shares of performance based nonvested shares pursuant to the Amended Plan. The shares were granted to key employees of the Company. The grant is performance based and cliff vests after the requisite service period of three years if certain financial goals are met. The goals are based upon cumulative diluted earnings per share (EPS) totals for the 2007, 2008 and 2009

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fiscal years as well as the return on invested capital for the same period. The number of shares granted can double if the financial goals are exceeded or no shares can be granted if the financial goals are not met. The Company is expensing the nonvested shares over the requisite service period of three years beginning January 1, 2007. If the Company believes that the number of shares granted will be more or less than originally projected, an adjustment to the expense will be made at that time based on the probable outcome. The weighted average price per share at grant date was $44.65. As of December 31, 2007, total future compensation costs related to nonvested share awards granted under the Long-Term Incentive Program are estimated to be $2,660,000. The Company assumed a 7.5% forfeiture rate for this grant and the shares have a weighted average life of 2.0 years as of December 31, 2007. During 2007, 2,100 shares were cancelled under the Long-Term Incentive Program.

13. Earnings per Share:

Basic earnings per share (EPS) are computed by dividing income available to common shareholders by weighted average common shares outstanding. Diluted EPS are computed using the same components as basic EPS with the denominator adjusted for the dilutive effect of stock warrants, stock options and nonvested share awards. Share-based awards that are contingent upon the attainment of performance goals are not included in the computation of diluted EPS until the performance goals have been attained. The dilutive effect of stock options and nonvested shares is computed using the treasury stock method, which assumes any proceeds that could be obtained upon the exercise of stock options and vesting of nonvested shares would be used to purchase common shares at the average market price for the period. The assumed proceeds include the windfall tax benefit that would be received upon assumed exercise. The following table provides a reconciliation between the computation of basic EPS and diluted EPS for the years ended December 31, 2007, 2006 and 2005:

	For the years ended December 31,								
	2007			**2006**			**2005**		
	Net Income	Weighted Average Common Shares	EPS	Net Income	Weighted Average Common Shares	EPS	Net Income	Weighted Average Common Shares	EPS
Basic EPS	$ 48,241,198	15,646,370	$ 3.08	$ 44,489,816	15,910,795	$ 2.80	$ 36,771,995	15,641,862	$ 2.35
Dilutive effect of stock options, warrants and nonvested share awards		132,321			171,003			506,841	
Diluted EPS	$ 48,241,198	15,778,691	$ 3.06	$ 44,489,816	16,081,798	$ 2.77	$ 36,771,995	16,148,703	$ 2.28

As of December 31, 2007, 2006 and 2005, there were no antidilutive options outstanding.

14. Stockholders Equity:

Shares of common stock outstanding were as follows for the years ended December, 31 2007, 2006 and 2005**:**

Common Stock

December 31, 2004	15,498,210
Exercise of warrants, options and vesting of nonvested shares	235,549
Issuance of common stock for acquisition	33,684
December 31, 2005	15,767,443
Exercise of warrants, options and vesting of nonvested shares	219,989
December 31, 2006	15,987,432
Exercise of warrants, options and vesting of nonvested shares	170,828
Issuance of common stock for acquisition	796
Repurchase and cancellation of common stock	(1,000,000)
December 31, 2007	15,159,056

Cash Dividends Paid on Common Stock:

On April 23, 2007, the Company s Board of Directors authorized a special one-time cash dividend of $1.00 per share with a record date of May 9, 2007. The cash dividends were paid on June 8, 2007 and totaled $16,069,694.

Share Repurchase Program:

On April 23, 2007, the Company s Board of Directors authorized a share repurchase program to buyback one million of the Company s outstanding shares of common stock on the open market. The timing and volume of share purchases were dependent on several factors, including market conditions. During the year ended December 31, 2007, the Company purchased 1,000,000 shares of its common stock at an average per share price of $50.56. There are no shares remaining to be repurchased under the share repurchase program as of December 31, 2007.

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15. Income Taxes:

Prior to November 8, 2002, the Company was organized as a limited liability company, taxed as a partnership, and as such was not subject to federal or state income taxes. Immediately before the IPO, the Company was reorganized as a corporation and became subject to income taxes.

On July 13, 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The evaluation of a tax position in accordance with FIN 48 is a two-step process. The first step is recognition: the enterprise determines whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the enterprise should presume that the position will be examined by the appropriate taxing authority that would have full knowledge of all relevant information. The second step is measurement: a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

The Company adopted the provisions of FIN 48 with respect to all of its tax positions as of January 1, 2007. Total unrecognized tax benefits as of December 31, 2007 and the date of adoption were $180,000 and $379,000, respectively. Due to the approval by the Internal Revenue Service of an application for a change in accounting method with respect to one of the Company s tax positions, the balance of unrecognized tax benefits was reduced by $208,000 during 2007. This reduction did not have an impact on the annual effective rate since the ultimate deductibility of these benefits was highly certain, and only the timing of deductibility was uncertain. The remaining unrecognized tax benefits balance of $180,000 as of December 31, 2007 relates to items that when recognized would result in an adjustment to additional paid-in capital and, therefore, would not affect the annual effective tax rate. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at January 1, 2007	$ 379,000
Additions for tax position of prior year	9,000
Decrease due to change in accounting method for tax purposes	(208,000)
Balance at December 31, 2007	$ 180,000

The Company was notified on June 21, 2007 that it is currently being examined by the Internal Revenue Service for the 2005 tax year. As of December 31, 2007, the tax years that remain subject to examination by the major taxing jurisdictions, including the Internal Revenue Service, are 2002 and subsequent years. The 2002 and 2003 tax years are still open to examination because of net operating losses that originated in those years but were not fully utilized until the 2004 and 2005 tax years.

FIN 48 requires the recognition of interest, if the tax law would require interest to be paid on the underpayment of taxes, and recognition of penalties, if a tax position does not meet the minimum statutory threshold to avoid payment of penalties. Penalties and interest may be classified as either penalties and interest expense or income tax expense. Management has elected to classify accrued penalties and interest as income tax expense. Accrued penalties and interest as of January 1, 2007, in the amount of $77,000, were recorded to beginning of year retained earnings. Total interest expense in the amount of $27,036 was recorded in income tax expense for the year ended December 31, 2007. Due to the approved application for change in accounting method, the balance of accrued penalties and interest was reduced by $67,475 during 2007.

Portfolio Recovery Associates, Inc.
Notes to Consolidated Financial Statements

The income tax expense recognized for the years ended December 31, 2007, 2006 and 2005 is composed of the following:

For the year ended December 31, 2007	**Federal**	**State**	**Total**
Current tax expense	$ 4,870,000	$ 453,903	$ 5,323,903
Deferred tax expense	21,228,785	3,105,327	24,334,112
Total income tax expense	$26,098,785	$3,559,230	$29,658,015