Encore Capital Group, Inc.
First Quarter 2018 Conference Call Prepared Remarks
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Slide #	Commentary
	Bruce Thomas
1	Thank you, Operator. Good afternoon and welcome to Encore Capital Group's first quarter 2018 earnings call. With me on the call today are Ashish Masih, our President and Chief Executive Officer, Jonathan Clark, Executive Vice President and Chief Financial Officer, and Paul Grinberg, President of Encore's International business. Ashish and Jon will make prepared remarks today, and then we will be happy to take your questions.
2 Safe Harbor	Before we begin, we have a few housekeeping items. Unless otherwise noted, comparisons made on this conference call will be between the first quarter of 2018 and the first quarter of 2017. Today's discussion will include forward-looking statements subject to risks and uncertainties. Actual results could differ materially from these forward-looking statements. Please refer to our SEC filings for a detailed discussion of potential risks and uncertainties. During this call, we will use rounding and abbreviations for the sake of brevity. We will also be discussing non-GAAP financial measures. Reconciliations to the most directly comparable GAAP financial measures are included in our earnings presentation, which was filed on Form 8-K earlier today. As a reminder, this conference call will also be made available for replay on the Investors section of our website, where we will also post our prepared remarks following the conclusion of this call. With that, let me turn the call over to Ashish Masih, our President and Chief Executive Officer.

	Ashish Masih
3 Introduction / Agenda	Thanks, Bruce, and good afternoon everyone. Thank you for joining our conference call. Today, we are excited to announce that we have agreed to acquire the remaining portion of Cabot Credit Management. This transaction brings significant strategic benefits to both companies and is financially very compelling for Encore, as it will be accretive to our earnings per share and will increase our expected earnings growth rate. In addition, the expected IRR on this transaction is very attractive. On today's call, we plan to review the acquisition, provide a summary of our first quarter 2018 performance, and update the earnings growth outlook we provided in February, which will improve due to the impact of the transaction.

4 Cabot Transaction Overview	To begin, the transaction solidifies our position as a global leader in our sector. Strategically, this transaction is a natural continuation of the path we embarked upon when we originally acquired a stake in Cabot in 2013; and reflects the successful expansion of Cabot's business over the past five years. We view Cabot as the best platform for long-term leadership and growth in Europe, and this transaction cements the strategic benefits of this partnership. While we remain highly focused on the U.S. market, the large and growing European NPL market continues to provide significant attractive opportunities for us to deploy capital. In addition, a number of factors, such as new European Central Bank regulations, are likely to drive additional debt sales volume in the future. We concluded years ago that it was important to reduce the risk of operating as a monoline player in a single market, and our diversification strategy provides alternate opportunities for capital deployment and profitability in those periods when the domestic debt buying market cycle is out of favor. While the U.S. market is very attractive at the current time, our investments in other geographies, including the transaction we announced today, should reduce volatility in our overall business over time. Our European business, led by Cabot, has also developed a number of product specialties including credit cards, loans, mortgages, REO, SME debt, telco, utilities debt, auto and IVAs, as well as servicing and BPO capabilities. In addition to the strategic merits of this acquisition, the transaction is highly attractive financially to Encore: • First, the expected IRR is greater than 15%, • Second, the deal is accretive to earnings in 2018 and beyond, • Third, this acquisition simplifies our complex financials and our company structure.

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Cabot Transaction Overview (continued)	Looking more closely at these financial benefits, this deal is immediately accretive to earnings. Last quarter, we said that our earnings growth percentage in 2018 was expected to be comparable to our growth in 2017. Today, we reaffirm our previous expectations, and note that if this transaction closes on June 30, we expect our earnings per share to grow in 2018 by at least 20%, keeping in mind that this incremental earnings growth reflects only 6 months of full Cabot ownership. Increasing the clarity of our message is a less obvious driver of shareholder value, but an important one nonetheless, as we've simplified our structure and clarified our place in the market. This transaction provides resolution to the ongoing question regarding Cabot's ownership and is expected to remove much of the complexity associated with noncontrolling interest in our financial results and the Preferred Equity Certificates - or PECs – in the existing ownership structure. This is also a very low-risk transaction as we have had the opportunity to be closely engaged in the management and strategic direction of Cabot's business for the past five years, and as a result, we know this company extremely well. There is minimal integration risk involved in our plans. This transaction is expected to only minimally increase our debt – and only in the near term – while equity issued to the sellers, including JC Flowers, will actually drive a reduction in our debt to equity ratio. We have also hedged the cash portion of the purchase price to protect against any exchange rate movements between now and closing. The Cabot management team has been a great partner over the past five years, and we expect them to stay in place and continue to operate successfully and deliver profitable growth.

5 Cabot Transaction Summary	We are purchasing the portion of Cabot that we do not yet own, representing approximately 57% of the common share ownership and a total of 53% of the economic ownership, including the Preferred Equity Certificates – or PECs – that we do not own today. The total consideration will be 5 million shares of Encore stock and £175.5 million pounds in cash, reflecting an equity valuation for Cabot of approximately £620 million pounds, which we believe to be a very attractive price. The transaction is expected to close within 90 days, subject to HSR approval and other customary closing conditions. We have committed financing in place to fund the cash portion and we have a variety of options available to us for permanent financing. Debt leverage is an important consideration in any transaction, including this one. We believe that we must operate our business within an acceptable band of debt leverage to be most effective. Cabot will continue to fund itself on a standalone basis going forward, and its debt will remain non-recourse to Encore. Although Cabot carries a higher level of debt than our domestic business, their back book includes a large number of paying accounts. In addition, after the acquisition of Westcot last fall, they are generating more cash and have more capital-light servicing revenue, which supports their higher leverage. We would also like to emphasize that despite stock being issued to complete this transaction, the deal remains highly accretive from an earnings perspective.

6 Cabot Review	As a quick review for new investors, we wanted to take a moment to briefly discuss Cabot and the strength of their organization. Since our initial investment in Cabot in 2013, management has significantly increased the company's scale, improved operational capabilities and achieved meaningful efficiency gains. Over the past 5 years, we believe Cabot has separated itself from the competition in the U.K. market and Ireland, by driving superior returns based on investments they've made in their call centers and their legal collections network. Through a combination of organic efforts and strategic acquisitions, Cabot has expanded its geographic footprint to include Spain, Portugal and France, and added liquidation expertise in consumer secured and SME accounts, as well as capabilities in the emerging BPO segment. Encore's Grove subsidiary, which specializes in U.K. IVAs and has additional servicing capabilities as well as portfolios purchased in Spain and Italy, will be aligned with Cabot through this transaction, supplementing Cabot's capabilities. In addition, Cabot, through their recent acquisition of Wescot, as well as other entities, has significantly increased their debt servicing operations, which not only provides an attractive source of cash flow, but also strengthens their relationships with issuers and creates an additional avenue to acquire portfolios. Through investments in operational and litigation expertise, combined with their use of data analytics and behavioral science, Cabot has been able to deliver collections performance that exceeds industry benchmarks together with strong cost efficiency. We believe Encore's sophisticated collections capabilities and technology will be additive to Cabot's own operations over time, and we expect both companies will benefit from sharing their full expertise. As a result of all of these initiatives, Cabot has demonstrated a strong track record of profitable growth, achieving a compounded annual growth rate of 20% in cash collections from 2012 to 2017.

6 Cabot Review (continued)	Cabot has a seasoned back book that is resilient to changes in economic conditions, with 72% of its U.K. collections coming from regular payers in 2017. Importantly, Cabot is very much in line with Encore's consumer-centric culture, was the first large debt purchaser to receive FCA approval in the UK, and, as a result, is viewed as a strong partner for issuers in managing their reputational risk. As a result of this track record, we believe Cabot is the premier platform to be a leading long-term player in the European debt buying and recovery space for years to come.

7 Encore's Growth Strategy	Encore's growth strategy remains two-pronged: First, focus on opportunities in the U.S. And second, strengthening and developing our international businesses. In the U.S., we're focusing our efforts on continued liquidation improvement and managing expenses in an environment in which we're increasing capacity, while ramping up deployments at attractive IRRs. We'll continue to develop key competitive advantages in technology, analytics, operations and compliance. Because of our responsiveness to market changes in the U.S. and our comprehensive understanding of the U.S. market, we believe we are well-positioned to maximize benefits from the current market environment and to achieve strong risk-adjusted returns. We've also demonstrated through today's announced transaction that strengthening and developing our international business continues to be an important pillar in our overall growth strategy. Our global reach and scale provide significant competitive advantages. Our large data warehouse leads to improved pricing and collections. We are able to purchase large portfolios and our economies of scale provide us the ability to absorb fixed costs for necessary investments in compliance and risk management. We have access to global funding sources and our global reach enables us to better serve multinational financial institution clients. Perhaps as important as all of these differentiators is our market reputation around the globe as a consumer-centric operator. Banks and issuers reward us with additional business as they look to us to help them manage reputational risk and take care of consumer relationships after default. As a result of our growth strategy, Encore has become a diversified global leader in our industry, capable of deploying capital across markets where we see the most attractive opportunities. I'd now like to review Encore's U.S. business…

8 U.S. Market	Consistent with recent trends, debt purchasing conditions in the U.S. market remain favorable. All indications from the Federal Reserve and U.S. banks continue to support our view that the supply of charged-off credit card receivables is on track for continued growth for this year and beyond. Consistent with this backdrop of healthy supply, pricing remains favorable. According to our estimates, the expansion of the fresh paper segment in relation to seasoned paper continues and we expect more than 80% of the volume sold in the market in 2018 will be comprised of fresh portfolios. We continue to make steady progress in adding collections capacity at our sites around the world and within our legal collections network, in an effort that began more than a year ago. In support of this expansion initiative, we incurred $14 million dollars of incremental expenses in the first quarter. With issuers selling more of their accounts sooner after charge-off, and given our proficiency in fresh paper collections, we are capitalizing on larger buying opportunities in the market. The first quarter was strong from a deployment perspective as we purchased $166 million dollars of charged-off credit card receivables and an additional $13 million dollars of bankruptcy debt. Reflecting the growth in the U.S. market and the strength of our issuer relationships, our forward flow commitments for 2018 remain well above historic levels for our business. As an indication of how favorable the purchasing environment has become in the U.S., we deployed 47% more capital in the first quarter this year than we did a year ago, while generating 58% more ERC, reflecting the improved efficiency of our deployments. We want to be clear that we believe the transaction to purchase the remainder of Cabot does not limit our ability to capitalize on these opportunities in the U.S. We continue to see strong growth in domestic supply at attractive returns, that we expect will contribute to our results for many years to come.

8 U.S. Market (continued)	I'd now like to hand the call over to Jon for a detailed look at our first quarter results…

	Jonathan Clark
9 Detailed Financial Discussion	Thank you, Ashish. Before I go into our financial results in detail, I would like to remind you, that as required by US GAAP, we are showing 100 percent of the results for Cabot, Refinancia and Baycorp in our financial statements. Where indicated, we will adjust the numbers to account for non-controlling interests.
10 Q1 Results	Turning to Encore's results in the first quarter, Encore earned GAAP net income from continuing operations of $22 million dollars, or $0.83 per share**.** Adjusted income was $26 million dollars or $0.98 per share. We reported record cash collections in the quarter of $489 million dollars and our ERC at March 31 was $7.1 billion dollars, also an all-time high for our business.
11 Q1 Deployments	Deployments totaled $277 million dollars in the first quarter and were up 27% compared to the first quarter of 2017. In the United States, $166 million dollars of our total $179 million dollars of deployments represented charged-off credit card paper, comprised almost exclusively of fresh portfolios. We also deployed $13 million dollars in bankruptcy receivables. European deployments through Cabot and Grove totaled $87 million dollars during the first quarter, compared to $85 million dollars in deployments in the same quarter a year ago. We deployed $10 million dollars in other geographies in the first quarter, including purchases in Australia and in Latin America.

12 Q1 Collections	Worldwide collections grew 11 percent to a record $489 million dollars in the first quarter, compared to $441 million dollars a year ago. Collections in our domestic call centers reached a new all-time high, up 17% compared to Q1 last year, as we continue to benefit from increased purchasing volumes and the acquisition in recent periods of portfolios with higher returns. Also keep in mind, as Ashish mentioned earlier, given the expected continued growth in the U.S. market, we are investing to increase the capacity of our call centers and legal collections network. Cabot also recorded record collections in the first quarter, growing 27% compared to the same quarter last year.
13 Q1 Revenue	Worldwide revenue in the first quarter grew 20 percent to $327 million dollars, compared to $272 million dollars in the prior year. Domestic revenue in the first quarter was $172 million dollars. Q1 revenue in Europe was $130 million dollars and grew primarily as a result of the increase in collections driven by our liquidation improvement initiatives and Cabot's acquisition of Wescot, which added servicing revenue. In the first quarter, we increased domestic yields primarily in pool groups in the 2015 and 2016 vintages as a result of sustained over-performance. In Europe, we increased yields on certain pool groups in the 2014 through 2016 vintages, also as a result of sustained over-performance. Encore generated $31 million dollars of zero-basis revenue in Q1, compared to $39 million dollars in the same period a year ago.

14 ERC	Our Estimated Remaining Collections, or ERC, established a new all-time high of $7.1 billion dollars at the end of the first quarter, and was up 21%, or $1.2 billion dollars, compared to the end of the same quarter a year ago.
15 Q1 EPS Walk	In the first quarter, we recorded GAAP earnings from continuing operations of $0.83 per share. In reconciling our GAAP earnings to our adjusted earnings, and after applying the income tax effect and adjusting for non-controlling interest, we recorded adjusted EPS of $0.98 per fully diluted share, and our non-GAAP Economic EPS was also $0.98. We did not exclude any shares from the calculation of our Economic EPS in the first quarter. Notably, in order to increase collections on certain accounts, we accelerated $2 million dollars of legal expenses into Q1, a time when consumers had more available cash from a combination of income tax refunds and increased after-tax paychecks driven by recent changes in the tax code. This incremental spending impacted earnings by approximately $0.06 per share in Q1, which we expect will be offset during the remainder of 2018. With that, I'd like to turn it back over to Ashish.

	Ashish Masih
16 Summary and Improved Expectations	Thank you, Jon. In summary, I am excited about what I see on the horizon for Encore. We recorded record cash collections in the first quarter and established a new, all-time high level of ERC. The supply pipeline in the U.S. remains very strong and we are purchasing large amounts of receivables at the strongest returns we've seen in several years. We're in a strong position from a capacity perspective and we expect to continue to benefit from these favorable buying conditions for some time. Our acquisition of the remaining interest in Cabot is the culmination of years of hard work and we believe that we've achieved a very favorable outcome. The acquisition provides us with numerous strategic and financial benefits. This transaction is accretive to earnings from Day 1. Assuming a June 30 close, we expect our annual earnings growth rate in 2018 to be at least 20%, keeping in mind that we will only be 100% owners of Cabot for six months of the year. The expected IRR on this transaction is compelling, in excess of 15%. This acquisition is an important step in solidifying our position as a global leader in our industry, capable of deploying capital across markets where we see the most attractive opportunities.

17 Q&A Session	Now we'd be happy to answer any questions that you may have. Operator, please open up the lines for questions.
18	That concludes the call for today. Thanks for taking the time to join us and we look forward to providing our second quarter 2018 results in early August.