



Analysis of Sales/Earnings

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Encore Capital Group, Inc.

(ECPG, \$39.38, Outperform, Target: \$40.00)

2Q20 First-Look: Strong Earnings Rebound on Cash Collections & Lower Expenses

Summary

ROCK[\$4.13;\$4.34;\$2.27;\$2.58] Earnings rebounded meaningfully Q/Q on higher revenue and lower expenses. Roughly half the estimated cash collections that were pushed out/deferred due to Covid were recouped in 2Q, which primarily drove the beat. ERC was flat Q/Q at \$8.4 billion. Management noted strong collection trends domestically had continued into July, with a partial offset being somewhat weaker supply outlook near-term in Europe. In sum, we view the quarter positively.

- **Operating EPS of \$4.34 beat our \$2.58, mostly driven by stronger realized cash collections in 2Q.** The company noted that its domestic cash collections in 2Q were 29% higher than its 2Q collection curves, and Cabot's collections were 17% higher than what the company estimated for the quarter. Those over-collections drove the \$66 million allowance reversal in 2Q, which was the primary driver of the beat. Additionally, although we captured the drop in legal expenses that management guided to last quarter, opex still beat us by \$0.16.
- Recall, the company posted a 1Q core loss due to an allowance charge (see [note](#)), as it adjusted its collection estimates around Covid. It was essentially too conservative in that allowance (hence the recovery in 2Q of about half of what it pushed out). We ultimately think investors should view the combination of 1Q and 2Q as an exercise in "fine tuning" the collection curves around Covid (and therefore, the average EPS of around \$2/share is probably a decent starting point for a run-rate for forward EPS).
- **Adjusted EBITDA of \$343.1 million beat our \$273.9 million estimate and was up about 6% Y/Y.** The company noted that Cabot's cost management enabled strong profitability despite Covid's impact on recognizing the timing of collections. New deployments were only \$25 million for Cabot, and \$125 million in the U.S., where the company noted it deployed at an average ERC multiple of 2.5x.
- **Our estimates are still under review,** but we expect the combination of strong collection trends into July, as well as lower funding costs should offset the higher legal collection expenses the company expects going forward (see our recent [note](#) on new credit agreements). Management guided to legal costs picking back up to around \$50-60 million/quarter going forward. At the same time, it noted that all else equal, it would expect further over-collections in 3Q (though not at the same magnitude as 2Q).

Flash Note

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- **We view it as a strong quarter**, and we think the overall trends support the company maintaining a balanced capital structure, which should enable it to absorb a potential glut of new supply as charge-offs make their way into the market next year. We think there's upside to the stock given the outlook to generate very strong cash-on-cash returns without potentially needing to raise leverage.
- We see positive read-through for **PRAA's** earnings, which are out on Thursday evening, as we expect realized cash collections in 2Q also posted a strong beat versus the company's Covid-adjusted curves. We also expect management will likely echo the somewhat slower near-term outlook around new purchases in Europe, as Encore noted banks have paused much of their sales activity (see our recent [note](#)).



Encore Capital Group (ECPG)

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	Reported	\$4.13	Operating	\$4.34	Consensus	\$2.27	KBW	\$2.58
(\$ in millions, except per share amounts)	2Q20 Actual	2Q20 Expected	Δ to Forecast	Q/Q 1Q20	Y/Y 2Q19	% Δ Q/Q	% Δ Y/Y	
INCOME STATEMENT								
Income Recognized on Receivables	\$335.3	\$347.1	(\$0.29)	\$357.4	\$312.5	-6%	7%	
Allowance Reversal (Charge)	\$66.0	\$0.0	\$1.64	(\$98.7)	\$2.1	-167%	3100%	
Other Revenue	\$24.7	\$20.0	\$0.12	\$30.4	\$32.3	-19%	-23%	
Total Revenues	\$426.0	\$367.1	\$1.47	\$289.1	\$346.9	47%	23%	
Total Operating Expenses	\$206.3	\$212.6	\$0.16	\$241.9	\$233.1	-15%	-11%	
Interest expense	(\$50.3)	(\$56.6)	\$0.16	(\$54.7)	(\$63.9)			
Total Other Income	(\$3.0)	\$0.0	(\$0.08)	\$1.4	(\$1.2)	-309%	142%	
Pre-Tax Earnings	\$166.4	\$97.9	\$1.70	(\$6.0)	\$48.6	-2863%	242%	
Effective Tax Rate	21.4%	22.0%		-75.7%	24.2%			
Income Taxes	(\$35.6)	(\$21.5)	(\$0.35)	(\$4.6)	(\$11.8)			
Net Income	\$130.8	\$76.4	\$1.35	(\$10.6)	\$36.8	-1336%	255%	
Non-Controlling Interest	(\$0.5)	\$0.5	(\$0.02)	\$0.1	(\$0.2)			
GAAP Net Income Attributable to ECPG	\$130.3	\$76.9	\$1.33	(\$10.5)	\$36.7	-1347%	256%	
Core Income Adjustments (Tax Adjusted)	\$6.5	\$4.0	\$0.44	\$4.6	\$3.6			
Total Operating Income	\$136.9	\$80.9	\$1.77	(\$5.9)	\$40.3	-2421%	240%	
Sharecount			(\$0.02)					
Total Beat (Miss) vs. KBW			\$1.75					
PER SHARE DATA								
GAAP EPS	\$4.13	\$2.46	167 c/sh	(\$0.33)	\$1.17	446 c/sh	296 c/sh	
Operating EPS	\$4.34	\$2.58	175 c/sh	(\$0.19)	\$1.28	452 c/sh	305 c/sh	
Adjusted EBITDA	\$343.1	\$273.9	25%	\$331.2	\$324.0	4%	6%	
Net Debt / TTM Adj. EBITDA	2.42x	2.60x		2.58x	2.75x			
GAAP Book Value	\$33.41	\$31.04		\$29.03	\$29.08			
Avg. Fully Diluted Shares	31.6	31.3		31.3	31.4			
BALANCE SHEET & VOLUME								
Receivables Balance	\$3,201	\$3,216	0%	\$3,166	\$3,225	1%	-1%	
Total Assets	\$4,741	\$4,513	5%	\$4,615	\$4,811	3%	-1%	
Total Debt	\$3,354	\$3,312	1%	\$3,404	\$3,530	-1%	-5%	
Total Liabilities	\$3,698	\$3,543	4%	\$3,709	\$3,908	0%	-5%	
Total Equity	\$1,039	\$965	8%	\$903	\$900	15%	15%	
KEY STATS								
New Acquisitions	\$148	\$170	-13%	\$214	\$243	-31%	-39%	
Cash Collections	\$508	\$454	12%	\$527	\$515	-4%	-1%	
Est. Remaining Collections (ERC), \$Billions	\$8,382	\$8,293	1%	\$8,373	\$7,350	0%	14%	
OPERATING STATS								
Return on Avg. Receivables	17.2%	10.1%		-0.7%	5.0%			
Cost to Collect (Adj. OpEx / Cash Collections)	31.3%	37.7%		37.1%	36.6%			
Return on Equity	56.4%	34.6%		-2.5%	18.2%			

Source: Company Data and KBW Research.

**Companies Mentioned in This Report**

- PRA Group, Inc (PRAA: \$41.76, Outperform)

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Encore Capital Group, Inc. (ECPG)

Target Price: \$40.00



Risk Factors:

Risks to our outlook for ECPG include a reduction in the supply of receivables sold or an increase in the number of buyers, both of which could result in less attractive pricing. Other risks include sharply deteriorating economic conditions, a stricter regulatory environment, and weaker international exchange rates.

Valuation:

Our \$40 price target is based on roughly 3.75x EV/Adjusted EBITDA using our 2020 estimates. Our target is sensitive to a number of factors, including the macro environment and regulations. Generally, a 5% change in cash collections could drive a 5% change in our price target.

PRA Group, Inc (PRAA)

Target Price: \$42.00

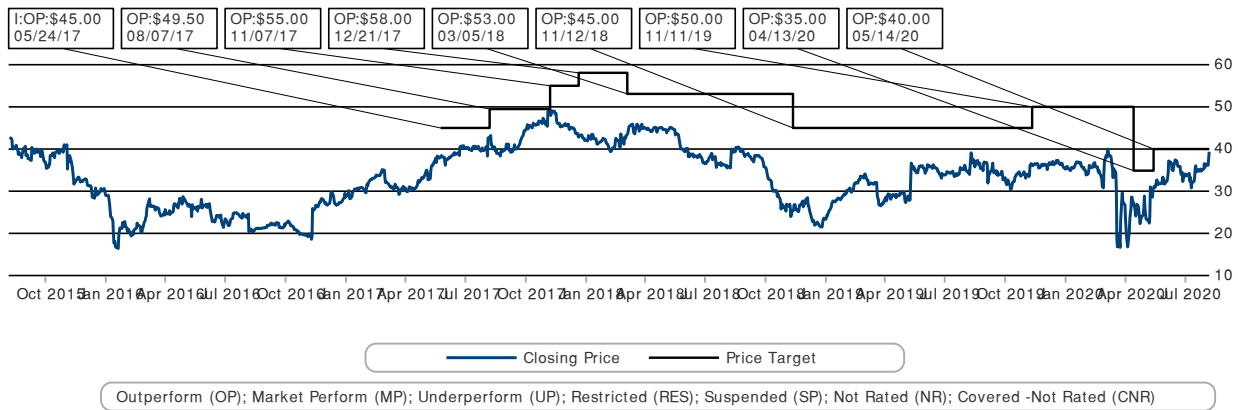
Risk Factors:

Risks to our outlook for PRAA include a declining pipeline of receivables coming to market, increased competition for receivables, and stricter regulation of third-party debt collectors.

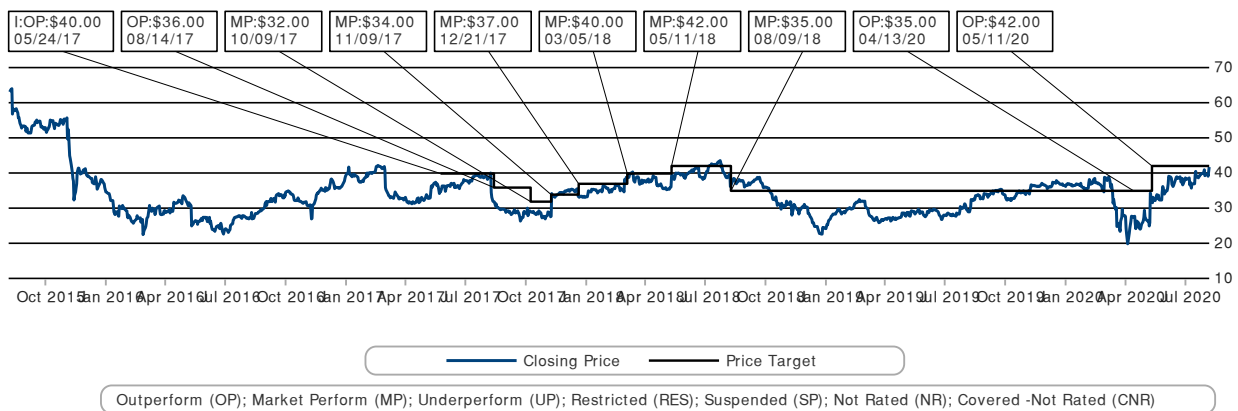
Valuation:

Our \$42 price target is based on roughly 4.0x our EV/adjusted EBITDA estimate using our 2020 estimates.

Rating and Price Target History for: Encore Capital Group, Inc. (ECPG) as of 08-05-2020



Rating and Price Target History for: PRA Group, Inc (PRAA) as of 08-05-2020



Note: The boxes on the Rating and Price Target History Chart above indicate the date of Report/Note, the rating and price target. Each box represents a date on which an analyst made a change to a rating or price target.

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