PORTFOLIO RECOVERY ASSOCIATES INC
Form 10-K
February 28, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

¨ **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	**NASDAQ Global Select Market**
(Title of Class)	**(Name of Exchange on which registered)**

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 þ NO ¨

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 ¨ 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 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 ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES þ NO ¨

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 to this Form 10-K. ¨

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.

Large accelerated filer	þ	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨

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

YES ¨ NO þ

The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2011 was $1,420,920,062 based on the $84.79 closing price as reported on the NASDAQ Global Select Market.

The number of shares of the registrant s Common Stock outstanding as of February 17, 2012 was 17,146,589.

Documents incorporated by reference: Portions of the registrant s definitive Proxy Statement for our 2012 Annual Meeting of Shareholders are incorporated by reference into 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, gross margin trends, operating cost trends, liquidity and capital needs and other statements of expectations, beliefs, future plans and strategies, anticipated events or trends, and similar expressions concerning matters that are not historical facts. The risks, uncertainties and assumptions referred to above may include the following:

- a prolonged economic recovery or a deterioration in the economic or inflationary environment in the United States or the United Kingdom, including the interest rate environment, that may have an adverse effect on our collections, results of operations, revenue and stock price or on the stability of the financial system as a whole;
- our ability to purchase defaulted consumer receivables at appropriate prices;
- our ability to replace our defaulted consumer receivables with additional receivables portfolios;
- our ability to obtain accurate and authentic account documents relating to accounts that we acquire and the possibility that documents that we provide could contain errors;
- our ability to successfully acquire receivables of new asset types;
- changes in the business practices of credit originators in terms of selling defaulted consumer receivables;
- changes in government regulations that affect our ability to collect sufficient amounts on our defaulted consumer receivables;
- changes in or interpretation of tax laws or adverse results of tax audits;
- changes in bankruptcy or collection laws that could negatively affect our business, including by causing an increase in certain types of bankruptcy filings involving liquidations, which may cause our collections to decrease;
- our ability to employ and retain qualified employees, especially collection personnel, and our senior management team;
- our work force could become unionized in the future, which could adversely affect the stability of our production and increase our costs;
- changes in the credit or capital markets, which affect our ability to borrow money or raise capital;

the degree and nature of our competition;

the possibility that we could incur goodwill impairment charges;

our ability to retain existing clients and obtain new clients for our fee-for-service businesses;

our ability to comply with regulations of the collection industry;

- our ability to successfully operate and/or integrate new business acquisitions;
- our ability to maintain, renegotiate or replace our credit facility;
- our ability to satisfy the restrictive covenants in our debt agreements;
- our ability to manage risks associated with our international operations acquired on January 16, 2012;
- the imposition of additional taxes on us;
- changes in interest rates, which could reduce our net income, and the possibility that future hedging strategies may not be successful, which could adversely affect our results of operations and financial condition, as could our failure to comply with hedge accounting principles and interpretations;
- the possibility that we could incur significant allowance charges on our finance receivables;
- our ability to manage growth successfully;
- the possibility that we could incur business or technology disruptions, or not adapt to technological advances;
- the possibility that we or our industry could experience negative publicity or reputational attacks;
- 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 section beginning on page 19, as well as the Management s Discussion and Analysis of Financial Condition and Results of Operations section beginning on page 35 and the Business section beginning on page 4.

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

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

PART I

Item 1. Business.
General

Our business focuses upon the detection, collection, and processing of both unpaid and normal-course accounts receivable originally owed to credit grantors, governments, retailers and others. 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 fee-based services, including vehicle location, skip tracing and collateral recovery services for auto lenders, governments and law enforcement via PRA Location Services, LLC (PLS), revenue administration, audit and debt discovery/recovery services for local government entities through PRA Government Services, LLC and MuniServices, LLC (collectively PRA GS) and class action claims recovery services and related payment processing via Claims Compensation Bureau, LLC (CCB). We believe that the strengths of our business are our sophisticated approach to portfolio pricing, segmentation and servicing, our emphasis on developing and retaining our collection personnel, our sophisticated processing systems and procedures and our relationships with many of the largest consumer lenders in the United States.

Subsequent to year end, on January 16, 2012, we acquired 100% of the equity interest of Mackenzie Hall Holdings, Limited, and its subsidiaries (MHH). MHH operates in Kilmarnock, Scotland and has approximately 170 employees. MHH is in the accounts receivable management industry that includes collecting on both their owned portfolios and for third party originators on a contingent fee basis.

Definitions

We use the following terminology throughout this document:

Allowance charges refers to a reduction in income recognized on finance receivables on pools of finance receivables whose cash collection estimates are not received or projected to not be received.

Amortization rate refers to cash collections applied to principal on finance receivables as a percentage of total cash collections.

Buybacks refers to purchase price refunded by the seller due to the return of non-compliant accounts.

Cash collections refers to collections from customers on our owned portfolios.

Cash receipts refers to collections on our owned portfolios plus fee income.

Core accounts or portfolios refer to accounts or portfolios that are defaulted consumer receivables and are not in a bankrupt status upon purchase. These accounts are aggregated separately from purchased bankruptcy accounts.

EBITDA refers to earnings before interest, taxes, depreciation and amortization.

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

Fee income refers to revenues generated from our fee-for-service subsidiaries.

Income recognized on finance receivables refers to income derived from our owned debt portfolios.

Income recognized on finance receivables, net refers to income derived from our owned debt portfolios and is shown net of allowance charges.

Net finance receivable balance is recorded on our balance sheet and refers to the purchase price less principal amortization and net allowance charges.

Principal amortization refers to cash collections applied to principal on finance receivables.

Purchase price refers to the cash paid to a seller to acquire defaulted consumer receivables, plus certain capitalized costs, less buybacks.

Purchased bankruptcy accounts or portfolios refer to accounts or portfolios that are in bankruptcy when we purchase them and as such are purchased as a pool of bankrupt accounts.

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

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

Our debt purchase business specializes 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, 2011, we acquired 2,335 portfolios, representing more than 28 million customer accounts and aggregated into 132 pools for accounting purposes, with a face value of $64.6 billion for a total purchase price of $2.1 billion. 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. We have one reportable segment, receivables management, based on similarities among the operating units including homogeneity of services, service delivery methods and use of technology.

We have achieved strong financial results over the past ten years, with cash collections growing from $53.1 million in 2001 to $705.5 million in 2011. Total revenue has grown from $32.3 million in 2001 to $458.9 million in 2011, a compound annual growth rate of 30.4%. Similarly, pro forma net income has grown from $3.5 million in 2001 to net income attributable to Portfolio Recovery Associates, Inc. (PRA) of $100.8 million in 2011.

We were initially formed as Portfolio Recovery Associates, L.L.C., a Delaware limited liability company, on March 20, 1996. 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 PRA common stock, a new Delaware corporation formed on August 7, 2002. Accordingly, the members of Portfolio Recovery Associates, L.L.C. became the common stockholders of PRA, which became the parent company of Portfolio Recovery Associates, L.L.C. and its subsidiaries.

PRA 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, our current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended. 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

We Offer a Compelling Alternative to Debt Owners and Governmental Entities

We offer debt owners the ability to immediately realize value for their charged-off receivables throughout the post charge-off collection cycle, from receivables that have only been processed internally by the debt owner to receivables that have been subject to multiple internal and external collection efforts, whether or not subject to bankruptcy proceedings. This flexibility helps us to meet the needs of debt owners and allows us to become a trusted resource. Also, through our government services business, we have the ability to service state and local government s receivables in various ways. This includes such services as processing tax payments on behalf of the client and extends to more complicated tax audit and discovery work, as well as additional services that fill the needs of our clients.

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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 consistently collect more than our purchase price over the collection lifecycle of the defaulted consumer receivables portfolios we have acquired. In doing so, we have generated increasing profits and operational cash flow from these portfolio acquisitions, without relying on the resale of portfolios to achieve these results. We have not resold any of our purchased portfolios since 2002, and the portfolios we sold then were primarily in Chapter 13 bankruptcy proceedings. We stopped reselling these portfolios as we began the effort to build our own bankruptcy portfolio buying group which started purchasing bankrupt accounts in 2004.

By holding and collecting the accounts we purchase over the long-term, we create static pool history that we believe is unique among our peers. Our portfolio underwriting process utilizes the collection results, customer data, and account attributes held in our data warehouse. The warehouse contains data from more than 2,300 portfolios representing over 28 million accounts purchased over the last 15 years from large issuers and owners of consumer receivables. Our quantitative modeling continuously evolves as we incorporate new data and develop, test, and adopt new analysis tools that help us improve our underwriting accuracy.

The Core portfolio underwriting process includes both quantitative analytical modeling and qualitative judgment-based analysis that considers the effects of the origination, servicing, and collection history of the portfolios we price. The combination of our deep sample of purchase data, our sophisticated analytical modeling, and the underwriting judgment gained from underwriting thousands of portfolios affords PRA with a significant competitive advantage over our competition.

Ability to Hire, Develop and Retain Productive Collectors

We place considerable focus on our ability to hire, develop, motivate 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, Jackson, Tennessee, Houston, Texas and Fresno, California areas, where we maintain offices, also provide a sufficient potential workforce of eligible personnel. We have found that tenure is an important contributor of our collector effectiveness. We offer our collectors a competitive wage with the opportunity to receive 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. We have a comprehensive training program for new owned portfolio collectors which are conducted in our five 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 take data security and collection compliance very seriously. We employ a staff of Quality Control and Compliance employees whose role it is to monitor calls and observe collection system entries. We monitor and research daily exception reports that track significant account status movements and account changes. To enhance this process, we employ sophisticated call and work action recording systems which allow us to better monitor compliance and quality of our customer contacts. 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. In addition, we do not sell our purchased defaulted consumer receivables. Instead, we work them over the long-term enhancing our knowledge of a pool s long-term performance. 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 largest 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 and compliant 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. Similarly, if a credit originator sells a portfolio to a debt buyer who has a reputation for violating industry standard collecting practices, the reputation of the credit originator can be damaged. We consistently attempt to negotiate reasonable and mutually acceptable contract terms, resulting in a confident and expeditious closing process for both parties. 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.

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 substantially to include a group of experienced, seasoned executives, many coming from the largest, most sophisticated lenders in the country.

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 have acquired receivables of Visa®, MasterCard® and other 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, auto finance companies and other debt buyers. In addition, we make periodic visits to the operating sites of debt sellers and attend numerous industry events in an effort to develop account purchase opportunities. We also maintain active relationships with brokers of defaulted consumer receivables.

Portfolios by Type and Geography

The following chart categorizes our life to date owned portfolios as of December 31, 2011 into the major asset types represented (amounts in thousands):

Asset Type	**No. of Accounts**	**%**	**Life to Date Purchased Face Value (1)**	**%**	**Original Purchase Price (2)**	**%**
Major Credit Cards	16,679	60 %	$ 46,419,560	72 %	$ 1,617,992	76%
Consumer Finance	5,706	20	6,863,629	11	128,965	6
Private Label Credit Cards	5,071	18	7,222,361	11	344,940	16
Auto Deficiency	602	2	4,122,531	6	44,805	2
Total:	**28,058**	**100 %**	**$ 64,628,081**	**100 %**	**$ 2,136,702**	**100 %**

(1) Life to Date Purchased Face Value represents the original face amount purchased from sellers and has not been reduced by any adjustments, including payments and buybacks and reflects all accounts purchased regardless of whether or not we currently have the ability to collect on the account.

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(2) Original Purchase Price represents the cash paid to sellers to acquire portfolios of defaulted consumer receivables.

Since our formation, we have purchased accounts from approximately 150 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 that we acquire 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.

We refer to the groups of charged-off (non-bankrupt) defaulted consumer receivables we purchase as Core portfolios. The age of a Core portfolio (the time since an account has been charged-off) is an important factor in determining the price at which we will purchase the portfolio. Generally, there is an inverse relationship between the age of a Core portfolio and the price at which we will purchase the portfolio. This relationship is due to the fact that older Core portfolio receivables typically liquidate at lower rates. The accounts receivables management industry places Core portfolio 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, charged-off by the credit originator and 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 portfolios of accounts previously worked by four or more agencies and these are typically two to three years or more past due and receive an even lower price. In addition, we purchase portfolios of accounts that are included in consumer bankruptcies. These bankrupt accounts are typically filed under Chapter 13 of the U.S. Bankruptcy Code and have an associated payment plan that can range from 3 to 5 years in duration. We purchase portfolios of bankrupt accounts in both forward flow and spot transactions and, consequently, they can be at any age in the bankruptcy plan life cycle.

The following table summarizes our life to date portfolio purchases as of December 31, 2011, into the delinquency categories represented (amounts in thousands).

Account Type	No. of Accounts	%	Life to Date Purchased Face Value (1)	%	Original Purchase Price (2)	%
Fresh	1,756	6 %	$ 5,049,048	8 %	$ 456,669	21 %
Primary	4,247	15	7,569,342	12	370,850	17
Secondary	4,696	17				

(a) Identity of Party Involved	(b) Description of Asset	(c) Purchase Price	(d) Selling Price	(g) Cost of Asset	(h) Fair Value on Transaction Date	(i) Net Gain/(Loss)
Reporting Criterion III	Any series of transactions within the plan year involving securities of the same issue that, when aggregated, involves an amount in excess of five percent of the					

	current value of Plan					
* The Kroger Co.	The Kroger Co. Common Stock Fund	$ 111,524		111,524	111,524	
* The Kroger Co.	The Kroger Co. Common Stock Fund		$ 168,936	124,127	168,936	44,809

* Indicates party-in-interest to the Plan.

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Pursuant to the requirements of the Securities and Exchange Act of 1934, the trustees (or other persons who administer the employee benefit plan) have duly caused this annual report to be signed on its behalf by the undersigned hereunto duly authorized.

	THE KROGER CO. SAVINGS PLAN
Date: June 24, 2004	By: /s/ Paul Heldman
	Chairman of the Administrative Committee

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EXHIBIT INDEX

Exhibit No.	
23	Consent of Independent Accountants