CompuCredit Holdings Corp
Form 10-Q
August 10, 2009

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

For the quarterly period ended June 30, 2009

of

COMPUCREDIT HOLDINGS CORPORATION
a Georgia Corporation

IRS Employer Identification No. 58-2336689

SEC File Number 0-53717

Five Concourse Parkway, Suite 400
Atlanta, Georgia 30328
(770) 828-2000

CompuCredit Holdings Corporation has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the preceding twelve months and has been subject to such filing requirements for the past ninety days. CompuCredit Holdings Corporation is not yet required to file Interactive Data Files.

CompuCredit Holdings Corporation is an accelerated filer and is not a shell company.

As of July 31, 2009, 47,732,253 shares of Common Stock, no par value, of CompuCredit Holdings Corporation were outstanding. (This excludes 3,651,069 loaned shares to be returned.)

COMPUCREDIT HOLDINGS CORPORATION

FORM 10-Q

TABLE OF CONTENTS

Table of Contents

CompuCredit Holdings Corporation and Subsidiaries
Condensed Consolidated Balance Sheets (Unaudited)
(Dollars in thousands)

	June 30, 2009	December 31, 2008 (as adjusted)
Assets		
Cash and cash equivalents (including restricted cash of $17,741 at June 30, 2009 and $19,913 at December 31, 2008)	$102,639	$94,428
Securitized earning assets	471,366	813,793
Non-securitized earning assets, net:		
Loans and fees receivable, net (of $22,810 and $24,757 in deferred revenue and $56,735 and $55,753 in allowances for uncollectible loans and fees receivable at June 30, 2009 and December 31, 2008, respectively)	309,231	340,734
Investments in previously charged-off receivables	59,271	47,676
Investments in securities	3,598	4,678
Deferred costs, net	5,509	6,161
Property at cost, net of depreciation	39,292	48,297
Investments in equity-method investees	22,002	53,093
Intangibles, net	3,344	4,547
Goodwill	44,302	59,129
Prepaid expenses and other assets	43,870	52,575
Assets of discontinued operations	1,931	—
Total assets	$1,106,355	$1,525,111
Liabilities		
Accounts payable and accrued expenses	$96,900	$120,235
Notes payable and other borrowings	161,631	199,939
Convertible senior notes (Note 9)	304,572	299,834
Deferred revenue primarily from forward flow agreement	23,261	23,492
Current and deferred income tax liabilities	24,681	134,754
Liabilities related to discontinued operations	2,372	—
Total liabilities	613,417	778,254
Commitments and contingencies (Note 11)		
Equity		
Common stock, no par value, 150,000,000 shares authorized: 60,042,482 shares issued and 51,383,322 shares outstanding at June 30, 2009 (including 3,651,069 loaned shares to be returned); and 59,947,301 shares issued and 51,213,385 shares outstanding at December 31, 2008 (including 3,651,069 loaned shares to be returned)	—	—
Additional paid-in capital	522,053	522,571
Treasury stock, at cost, 8,659,160 and 8,733,916 shares at June 30, 2009 and December 31, 2008, respectively	(220,429)	(222,310)
Accumulated other comprehensive loss	(30,089)	(31,431)
Retained earnings	206,288	453,149

Total shareholders' equity (Note 2)	477,823	721,979
Noncontrolling interests (Note 2)	15,115	24,878
Total equity	492,938	746,857
Total liabilities and equity (Note 2)	$1,106,355	$1,525,111

See accompanying notes.

1

Table of Contents

CompuCredit Holdings Corporation and Subsidiaries
Condensed Consolidated Statements of Operations (Unaudited)
(Dollars in thousands, except per share data)

	For the Three Months Ended June 30, 2009	For the Three Months Ended June 30, 2008 (as adjusted)	For the Six Months Ended June 30, 2009	For the Six Months Ended June 30, 2008 (as adjusted)
Interest income:				
Consumer loans, including past due fees	$18,967	$24,866	$38,768	$47,782
Other	252	1,390	581	3,473
Total interest income	19,219	26,256	39,349	51,255
Interest expense	(10,018)	(12,949)	(20,210)	(26,939)
Net interest income before fees and related income on non-securitized earning assets and provision for loan losses	9,201	13,307	19,139	24,316
Fees and related income on non-securitized earning assets	40,926	49,775	83,572	104,151
Provision for loan losses	(18,555)	(15,704)	(30,808)	(35,885)
Net interest income, fees and related income on non-securitized earning assets	31,572	47,378	71,903	92,582
Other operating (loss) income:				
Loss on securitized earning assets	(161,688)	(60,661)	(313,714)	(18,068)
Servicing income	31,470	44,868	70,874	93,154
Ancillary and interchange revenues	5,229	15,710	11,227	31,131
Gain on repurchase of convertible senior notes	—	13,728	160	13,728
Gain on buy-out of equity-method investee members	20,990	—	20,990	—
Equity in (loss) income of equity-method investees	(7,833)	6,982	(10,015)	15,456
Total other operating (loss) income	(111,832)	20,627	(220,478)	135,401
Other operating expense:				
Salaries and benefits	13,843	17,908	28,075	36,687
Card and loan servicing	53,121	70,251	110,750	147,113
Marketing and solicitation	3,908	17,053	8,054	32,899
Depreciation	5,314	7,359	11,641	17,270
Goodwill Impairment	20,000	—	20,000	—
Other	25,309	35,815	50,503	64,497
Total other operating expense	121,495	148,386	229,023	298,466
Loss from continuing operations before income taxes	(201,755)	(80,381)	(377,598)	(70,483)
Income tax benefit	59,951	26,195	120,590	21,889
Loss from continuing operations	(141,804)	(54,186)	(257,008)	(48,594)
Discontinued operations:				
Loss from discontinued operations before income taxes	(6,750)	(3,098)	(6,599)	(7,176)
Income tax benefit	2,363	1,084	2,310	2,512
Loss from discontinued operations	(4,387)	(2,014)	(4,289)	(4,664)
Net loss	(146,191)	(56,200)	(261,297)	(53,258)
Net loss (income) attributable to noncontrolling interests	11,847	518	14,436	(1,501)
Net loss attributable to controlling interests	$(134,344)	$(55,682)	$(246,861)	$(54,759)

Loss from continuing operations attributable to controlling interests per common share—basic	$(2.72)	$(1.13)	$(5.09)	$(1.05)
Loss from continuing operations attributable to controlling interests per common share—diluted	$(2.72)	$(1.13)	$(5.09)	$(1.05)
Loss from discontinued operations attributable to controlling interests per common share—basic	$(0.09)	$(0.04)	$(0.09)	$(0.10)
Loss from discontinued operations attributable to controlling interests per common share—diluted	$(0.09)	$(0.04)	$(0.09)	$(0.10)
Net loss attributable to controlling interests per common share—basic	$(2.81)	$(1.17)	$(5.18)	$(1.15)
Net loss attributable to controlling interests per common share—diluted	$(2.81)	$(1.17)	$(5.18)	$(1.15)

See accompanying notes.

Table of Contents

CompuCredit Holdings Corporation and Subsidiaries
Condensed Consolidated Statement of Equity (Unaudited)
For the Six months ended June 30, 2009
(Dollars in thousands)

	Common Stock								
	Shares Issued	Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Noncontrolling Interests	Comprehensive Loss	Total Equity
Balance at December 31, 2008 (as adjusted)	59,947,301	$—	$522,571	$(222,310)	$(31,431)	$453,149	$24,878	$—	$746,857
Use of treasury stock for stock-based compensation plans	(111,644)	—	(1,996)	1,996	—	—	—	—	—
Issuance of restricted stock	206,825	—	—	—	—	—	—	—	—
Amortization of deferred stock-based compensation costs	—	—	4,387	—	—	—	—	—	4,387
Purchase of treasury stock	—	—	—	(115)	—	—	—	—	(115)
Tax effects of stock-based compensation plans	—	—	(1,317)	—	—	—	—	—	(1,317)
Settlement of contingent earn-out as referenced in Note 10, “Goodwill and Intangible Assets”	—	—	(1,592)	—	—	—	5,431	—	3,839
Distributions to owners of noncontrolling interests	—	—	—	—	—	—	(756)	—	(756)
Comprehensive loss:									
Net loss	—	—	—	—	—	(246,861)	(14,436)	(261,297)	(261,297)
	—	—	—	—	1,342	—	(2)	1,340	1,340

Foreign currency translation adjustment, net of tax									
Comprehensive loss	—	—	—	—	—	—	—	$(259,957)	—
Balance at June 30, 2009	60,042,482	$—	$522,053	$(220,429)	$(30,089)	$206,288	$15,115		$492,938

See accompanying notes.

3

Table of Contents

CompuCredit Holdings Corporation and Subsidiaries
Condensed Consolidated Statements of Comprehensive Loss (Unaudited)
(Dollars in thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008 (as adjusted)	2009	2008 (as adjusted)
Net loss	$(146,191)	$(56,200)	$(261,297)	$(53,258)
Other comprehensive loss:				
Foreign currency translation adjustment	15,075	33	13,247	(279)
Income tax (expense) benefit related to other comprehensive loss	(12,347)	—	(11,907)	96
Comprehensive loss	(143,463)	(56,167)	(259,957)	(53,441)
Comprehensive loss (income) attributable to noncontrolling interests	11,802	518	14,438	(1,505)
Comprehensive loss attributable to controlling interests	$(131,661)	$(55,649)	$(245,519)	$(54,946)

See accompanying notes.

Table of Contents

CompuCredit Holdings Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)
(Dollars in thousands)

	For the Six Months Ended June 30, 2009	For the Six Months Ended June 30, 2008 (as adjusted)
Operating activities		
Net loss	$(261,297)	$(53,258)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation expense	11,682	17,359
Impairment of goodwill	23,483	1,132
Provision for loan losses	31,500	36,509
Amortization and impairment of intangibles	1,203	1,250
Accretion of deferred revenue	(230)	(11,467)
Stock-based compensation expense	4,387	4,844
Retained interests adjustments, net	526,832	303,191
Unrealized loss on debt and equity securities classified as trading securities	—	1,950
Gain on repurchase of convertible senior notes	(160)	(13,728)
Interest expense accreted on convertible senior notes	4,991	5,090
Gain on buy-out of equity-method investee members	(20,990)	—
Income in excess of distributions from equity-method investments	—	(2,055)
Changes in assets and liabilities, exclusive of business acquisitions:		
Net (increase) decrease in valuation of debt, equity and U.S. government securities classified as trading securities	(163)	17,939
Decrease in uncollected fees on non-securitized earning assets	6,508	3,823
Decrease in deferred costs	652	1,290
(Decrease) increase in income tax liability	(123,513)	62,699
Increase in deferred revenue	—	1,914
Decrease (increase) in prepaid expenses	4,845	(23,186)
Decrease in accounts payable and accrued expenses	(20,445)	(22,357)
Other	4,527	10,542
Net cash provided by operating activities	193,812	343,481
Investing activities		
Purchase of third-party interest in equity-method investee	(19,542)	—
Proceeds from equity-method investees	50,633	5,314
Investments in securitized earning assets	(340,818)	(924,331)
Proceeds from securitized earning assets	186,844	701,806
Investments in non-securitized earning assets	(461,191)	(642,251)
Proceeds from non-securitized earning assets	443,739	564,392
Acquisition of assets	(621)	—
Purchases and development of buildings, software, furniture, fixtures and equipment, net of disposals	(2,084)	(8,895)
Net cash used in investing activities	(143,040)	(303,965)
Financing activities		
Noncontrolling interests distributions, net	(756)	(3,468)
Proceeds from exercise of stock options	—	74
Purchase of treasury stock	(115)	(515)

Purchase of noncontrolling interest	(1,096)	—
Proceeds from borrowings	41,351	60,735
Repayment of borrowings	(83,044)	(80,942)
Net cash used in financing activities	(43,660)	(24,116)
Effect of exchange rate changes on cash	1,099	(79)
Net increase in cash	8,211	15,321
Cash and cash equivalents at beginning of period	94,428	137,526
Cash and cash equivalents at end of period	$102,639	$152,847
Supplemental cash flow information		
Cash paid for interest	$16,116	$22,699
Net cash paid for (refunds of) income taxes	$613	$(87,094)
Supplemental non-cash information		
Notes payable associated with capital leases	$1,385	$6,839
Notes payable associated with investments in securities	$—	$—
Issuance of stock options and restricted stock	$1,129	$6,989

See accompanying notes.

Table of Contents

CompuCredit Holdings Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
June 30, 2009

1. Basis of Presentation

We have prepared our condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Securities and Exchange Commission ("SEC") Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete consolidated financial statements. In the opinion of management, all normal recurring adjustments considered necessary to fairly state the results for the interim periods presented have been included. The preparation of condensed consolidated financial statements in conformity with GAAP 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 our condensed consolidated financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Certain estimates, such as credit losses, payment rates, costs of funds, discount rates and the yields earned on securitized receivables, significantly affect our reported loss on retained interests in credit card receivables securitized (which is a component of loss on securitized earning assets on our condensed consolidated statements of operations) and the reported value of securitized earning assets on our condensed consolidated balance sheets. Additionally, estimates of future credit losses on our non-securitized loans and fees receivable have a significant effect on the provision for loan losses within our condensed consolidated statements of operations and loans and fees receivable, net, which is a component of non-securitized earning assets, net on our condensed consolidated balance sheets. Operating results for the three and six months ended June 30, 2009 are not necessarily indicative of what our results will be for the year ending December 31, 2009.

We have reclassified certain amounts in our prior period condensed consolidated financial statements to conform to current period presentation, and we have eliminated all significant intercompany balances and transactions for financial reporting purposes.

Our prior year reclassifications include those required for the retrospective application of two new accounting pronouncements that are first effective for us under GAAP in our 2009 consolidated financial statements—specifically, a pronouncement that resulted in the reclassification of our prior liability for minority interests to a new noncontrolling interests component of total equity, and a pronouncement that resulted in reclassifications of consolidated balance sheet balances from deferred loan costs and convertible senior notes to additional paid-in capital and in associated reclassifications among retained earnings and deferred tax liabilities. Retrospective application of this latter pronouncement also had the effect of increasing interest expense and, accordingly, decreasing net income within our condensed consolidated statements of operations for the three and six months ended June 30, 2008.

On June 30, 2009, we completed a reorganization through which CompuCredit Corporation, our former parent company, became a wholly owned subsidiary of CompuCredit Holdings Corporation. We effected this reorganization through a merger pursuant to an Agreement and Plan of Merger, dated as of June 2, 2009, by and among CompuCredit Corporation, CompuCredit Holdings Corporation and CompuCredit Merger Sub, Inc., and as a result of the reorganization, each outstanding share of CompuCredit Corporation common stock was automatically converted into one share of CompuCredit Holdings Corporation common stock.

As a result of the reorganization, CompuCredit Corporation common stock is no longer publicly traded, and CompuCredit Holdings Corporation common stock commenced trading on the NASDAQ Global Select Market on July 1, 2009 under the symbol "CCRT," the same symbol under which CompuCredit Corporation common stock was previously listed and traded.

The post-reorganization condensed consolidated financial statements presented herein are presented on the same basis as and can be compared to the condensed consolidated financial statements reported in CompuCredit Corporation's prior quarterly and annual reports filed with the SEC. The accompanying condensed consolidated balance sheet as of December 31, 2008 has been derived from and should be read in connection with the audited consolidated financial statements included in CompuCredit Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2008; likewise, it should be read in conjunction with management's discussion and analysis of financial condition and results of operations also contained in that Annual Report.

Table of Contents

2. Summary of Significant Accounting Policies and Condensed Consolidated Financial Statement Components

The following is a summary of significant accounting policies we follow in preparing our consolidated financial statements, as well as a description of significant components of our consolidated financial statements.

Restricted Cash

Restricted cash as of June 30, 2009 includes (1) $8.7 million of escrowed gross proceeds (including interest earned thereon) associated with a forward flow contract between one of our subsidiaries and a subsidiary of Encore Capital Group, Inc. (collectively with all other subsidiaries or affiliates of Encore Capital Group, Inc. to which we refer, “Encore”), (2) certain collections on receivables within our Auto Finance segment, the cash balances of which are required to be distributed to noteholders under our debt facilities, and (3) cash collateral balances underlying standby letters of credit that have been issued in favor of certain regulators in connection with our retail micro-loan activities.

On July 10, 2008, Encore did not purchase certain accounts as contemplated by the forward flow contract, alleging that we breached certain representations and warranties set forth in the contract (based upon then-outstanding allegations made by the Federal Trade Commission (“FTC”) as discussed further in Note 11, “Commitments and Contingencies”). Subsequently, both our subsidiary and Encore advised one another that they were in default of various obligations under the contract and various related agreements among them, and the parties currently are endeavoring to resolve these disputes through arbitration. Notwithstanding our settlement in December 2008 of all outstanding matters with the FTC, because of these ongoing disputes with Encore, we have not recognized subsequent to July 10, 2008 any income representing escrowed funds classified within restricted cash that we believe we have earned after that date but that Encore has not released from the escrowed funds.

Non-Securitized Earning Assets, Net

The components of non-securitized earning assets, net, on our consolidated balance sheets include loans and fees receivable, net, investments in previously charged-off receivables and investments in securities.

Loans and Fees Receivable, Net. Loans and fees receivable, net, currently consist principally of receivables associated with our retail and Internet micro-loan activities and our auto finance business.

As applicable, we show loans and fees receivable net of both an allowance for uncollectible loans and fees receivable and unearned fees (or “deferred revenue”) in accordance with applicable accounting rules.

We account for the loans and fees receivable associated with our acquisition of a $189.0 million auto loan portfolio from Patelco Credit Union (“Patelco”) under accounting rules that limit the yield that may be accreted (accretable yield) to the excess of our estimate of undiscounted expected principal, interest, and other cash flows (including the effects of prepayments) expected to be collected on the date of acquisition over our initial investment in the loans and fees receivable. The excess of contractual cash flows over cash flows expected to be collected (nonaccretable difference) is not recognized as an adjustment of yield, loss accrual or valuation allowance. The following tables show (in thousands) a roll-forward of accretable yield for our loans for which we apply these rules, as well as the carrying amounts of and gross loans and fees receivable balances of our loans for which we apply these rules.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Roll-forward of accretable yield:				

Balance at beginning of period	$(13,067)	$(24,314)	$(15,934)	$(28,737)
Impairment of accretable yield	(404)	—	(404)	—
Accretion of yield	2,548	3,951	5,415	8,374
Balance at end of period	$(10,923)	$(20,363)	$(10,923)	$(20,363)

Acquired loans and fees receivable subject to accretable yield accounting rules:

Carrying amount of loans and fees receivable at acquisition date	$160,592
Carrying amount of loans and fees receivable at June 30, 2009	$48,541
Gross loans and fees receivable balance at acquisition date	$191,976
Gross loans and fees receivable balance at June 30, 2009	$57,182

Table of Contents

A roll-forward of the components of loans and fees receivable, net (in millions) between our December 31, 2008 and June 30, 2009 consolidated balance sheet dates is as follows:

	Balance at December 31, 2008	Additions	Subtractions	Balance at June 30, 2009
Loans and fees receivable, gross	$ 421.3	$487.8	$ (520.4)	$388.7
Deferred revenue	(24.8)	(32.5)	34.5	(22.8)
Allowance for uncollectible loans and fees receivable	(55.8)	(30.8)	29.9	(56.7)
Loans and fees receivable, net	$ 340.7	$424.5	$ (456.0)	$309.2

As of June 30, 2009, the weighted average remaining accretion period for the $22.8 million of deferred revenue reflected in the above table was 24.4 months.

A roll-forward of our allowance for uncollectible loans and fees receivable (in millions) during each of the three and six months ended June 30, 2009 and 2008, respectively, is as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Balance at beginning of period	$(53.5)	$(54.5)	$(55.8)	$(51.5)
Provision for loan losses	(18.6)	(15.7)	(30.8)	(35.9)
Charge offs	16.7	16.8	32.8	36.7
Recoveries	(1.3)	(2.3)	(2.9)	(5.0)
Balance at end of period	$(56.7)	$(55.7)	$(56.7)	$(55.7)

Investments in Previously Charged-Off Receivables. The following table shows (in thousands) a roll-forward of our investments in previously charged-off receivables activities:

	For the Three Months Ended June 30, 2009	For the Six Months Ended June 30, 2009
Unrecovered balance at beginning of period	$ 55,488	$ 47,676
Acquisitions of defaulted accounts	14,278	31,651
Cash collections	(14,341)	(28,221)
Cost-recovery method income recognized on defaulted accounts (included within fees and related income on non-securitized earning assets on our consolidated statements of operations)	3,846	8,165
Unrecovered balance at end of period	$ 59,271	$ 59,271
Estimated remaining collections (“ERC”)	$ 125,844	$ 125,844

Our previously charged-off receivables consist of amounts associated with normal delinquency charged-off accounts, accounts for which debtors have filed for bankruptcy protection under Chapter 13 of the United States Bankruptcy Code (“Chapter 13 Bankruptcies”) and accounts participating in or acquired in connection with our balance transfer program prior to such time as we issue credit cards relating to the accounts.

We estimate the life of each pool of previously charged-off receivables acquired by us generally to be between twenty-four and thirty-six months for normal delinquency charged-off accounts and approximately sixty months for Chapter 13 Bankruptcies. We anticipate collecting 45.2% of the ERC of the existing accounts over the next twelve months, with the balance to be collected thereafter.

Table of Contents

Investments in Securities. We periodically have invested in debt and equity securities. We generally have classified our purchased debt and equity securities as trading securities and included realized and unrealized gains and losses in earnings in accordance with applicable accounting rules. Additionally, we occasionally have received distributions of debt securities from our equity-method investees, and we have classified such distributed debt securities as held to maturity. The carrying values (in thousands) of our investments in debt and equity securities are as follows:

	As of June 30, 2009	As of December 31, 2008
Held to maturity:		
Investments in debt securities of equity-method investees	$ 3,142	$ 4,385
Trading:		
Investments in equity securities	456	293
Total investments in securities	$ 3,598	$ 4,678

Prepaid Expenses and Other Assets

Prepaid expenses and other assets include amounts paid to third parties for marketing and other services. We expense these amounts once services have been performed or marketing efforts have been undertaken. Also included are (1) various deposits (totaling $22.4 million as of June 30, 2009) required to be maintained with our third-party issuing bank partners and retail electronic payment network providers (including $7.1 million as of June 30, 2009 associated with our ongoing servicing efforts in the United Kingdom) and (2) vehicle inventory held by our buy-here, pay-here auto dealerships that we expense as cost of goods sold (within fees and related income on non-securitized earning assets on our consolidated statements of operations) as we earn associated sales revenues.

Deferred Costs

The principal components of deferred costs include unamortized costs associated with our (1) receivables origination activities and (2) issuances of convertible senior notes and other debt. We defer direct receivables origination costs for our credit card receivables and amortize them against credit card fee income on a straight-line basis over the privilege period, which is typically one year. We generally amortize deferred costs associated with our convertible senior notes into interest expense over the expected life of the instruments; however, we accelerate the recovery of an appropriate pro-rata portion of these costs against gains on repurchases of our convertible senior notes. On January 1, 2009, we were required to adopt a GAAP pronouncement that resulted in the reclassification of $4.8 million of deferred loan costs associated with our convertible senior notes as a reduction to equity, and as required, we have retrospectively applied this pronouncement within prior period consolidated financial statements as if the accounting pronouncement had applied in financial reporting periods prior to its January 1, 2009 effective date. See Note 9, “Convertible Senior Notes, Notes Payable and Other Borrowings,” for additional effects of our adoption of this pronouncement.

Income Taxes

We account for income taxes based on the liability method required by applicable accounting rules. Under the liability method, deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Additionally, we assess the probability that a tax position we have taken may not ultimately be sustained on audit, and we reevaluate our uncertain tax positions on a quarterly basis. We base these reevaluations on factors including, but not limited to, changes in facts and circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. A change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to tax expense. The accounting rules also require that we assess the need to establish a valuation allowance against deferred tax assets by evaluating available evidence to determine whether it is more likely than not that some or all of the deferred tax assets will be realized in the future. To the extent there is insufficient positive evidence to support the realization of the deferred tax assets, we establish a valuation allowance.

We conduct business globally, and as a result, one or more of our subsidiaries files U.S. federal, state and/or foreign income tax returns. In the normal course of business we are subject to examination by taxing authorities throughout the world, including such major jurisdictions as the United States, the United Kingdom, and the Netherlands. With a few exceptions, we are no longer subject to U.S. federal, state, local, or foreign income tax examinations for years prior to 2005. Currently, we are under audit by various jurisdictions for various years, including the Internal Revenue Service for the 2007 tax year. Although the audits have not been concluded, we do not expect any changes to the tax liabilities reported in those years. If any such changes arise, however, we do not expect them to be material.

Table of Contents

We recognize potential accrued interest and penalties related to unrecognized tax benefits in income tax expense. We recognized $0.7 million and $1.4 million in potential interest and penalties associated with uncertain tax positions during the three and six months ended June 30, 2009 and June 30, 2008. To the extent such interest and penalties are not assessed as a result of a resolution of the underlying tax position, amounts accrued will be reduced and reflected as a reduction of income tax expense.

Our overall effective tax rates (computed considering results for both continuing and discontinued operations before income taxes in the aggregate) were 29.9% and 31.9% for the three and six months ended June 30, 2009, compared to 32.8% and 31.5% for the three and six months ended June 30, 2008. We have experienced no material changes in effective tax rates associated with differences in filing jurisdictions and changes in law between these periods, and the variations in effective tax rates between these periods are substantially related to the effects of a $10.7 million valuation allowance against income statement-oriented U.S. federal deferred tax assets during the three months ended June 30, 2009. As computed without regard to the effects of all U.S. federal, state, local and foreign tax valuation allowances taken against income statement-oriented deferred tax assets, our effective tax rates would have been 35.0% and 33.7% for the three and six months ended June 30, 2009, respectively, and 35.5% and 35.3% for the three and six months ended June 30, 2008, respectively.

In addition to the U.S. federal, state, local and foreign tax valuation allowances taken against income statement-oriented deferred tax assets in the three months ended June 30, 2009, we provided a $9.0 million valuation allowance against U.S. federal deferred tax assets related to the accumulated other comprehensive loss component within consolidated shareholders' equity in the three months ended June 30, 2009.

Fees and Related Income on Non-Securitized Earning Assets

Fees and related income on non-securitized earning assets primarily include: (1) lending fees associated with our retail and Internet micro-loan activities; (2) fees associated with our lower-tier credit card receivables during periods in which we have held them on balance sheet; (3) income associated with our investments in previously charged-off receivables; (4) gains and losses associated with our investments in securities; and (5) gross profits from auto sales within our Auto Finance segment.

The components (in thousands) of our fees and related income on non-securitized earning assets are as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Retail micro-loan fees	$16,566	$16,546	$33,242	$35,207
Internet micro-loan fees	15,104	10,052	26,892	17,770
Fees on lower-tier credit card receivables while held on balance sheet	—	2,761	—	5,403
Income on investments in previously charged-off receivables	3,846	11,029	8,165	29,826
Gross profit on auto sales	5,138	8,909	13,609	18,007
Gains (losses) on investments in securities	86	(1,090)	163	(6,251)
Other	186	1,568	1,501	4,189
Total fees and related income on non-securitized earning assets	$40,926	$49,775	$83,572	$104,151

Loss on Securitized Earning Assets

Loss on securitized earning assets is the net of (1) losses on retained interests in credit card receivables securitized and (2) returned-check, cash advance and certain other fees associated with our securitized credit card receivables, both of which are detailed (in thousands) in the following table.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Loss on retained interests in credit card receivables securitized	$ (165,579)	$ (68,160)	$ (323,834)	$ (33,838)
Fees on securitized receivables	3,891	7,499	10,120	15,770
Total loss on securitized earning assets	$ (161,688)	$ (60,661)	$ (313,714)	$ (18,068)

10

Table of Contents

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (the “FASB”) issued new accounting rules that, in addition to requiring certain new securitization and structured financing-related disclosures that have been incorporated into our condensed consolidated financial statements as of and for the three and six months ended June 30, 2009, are expected to result in the consolidation of our securitization trusts onto our consolidated balance sheet effective as of January 1, 2010. As a result, cash and credit card receivables held by our securitization trusts and debt issued from those entities will be presented as assets and liabilities on our consolidated balance sheet effective on that date. Initial adoption of these new accounting rules is expected to have a material impact on our reported financial condition. However, because we have not yet decided whether to exercise an available option under these rules under which we would be required to value both the credit card receivables and debt outstanding within our securitization trusts at fair value, we are uncertain whether our adoption of the new rules will result in materially favorable or adverse effects on our reported financial condition. If we exercise the fair value option permitted under the new rules, we expect favorable effects on our reported financial condition; whereas, if we do not exercise the fair value option, we expect adverse effects on our reported financial condition. Moreover, after adoption of these new rules, we will no longer reflect our securitization trusts’ results of operations within losses on retained interests in credit card receivables securitized, but will instead report interest income and provisions for loan losses (as well as gains and/or losses associated with fair value changes should we exercise the fair value option) with respect to the credit card receivables held within our securitization trusts; similarly, we will begin to separately report interest expense (as well as gains and/or losses associated with fair value changes should we exercise the fair value option) with respect to the debt issued from the securitization trusts. Lastly, because we will account for our securitization transactions under these new accounting rules as secured borrowings rather than asset sales, we will begin to present the cash flows from these transactions as cash flows from financing activities, rather than as cash flows from investing activities.

In April 2009, the FASB issued new other-than-temporary impairment accounting rules for debt securities, indicating that a company should continue to assess its intent and ability to hold a security to maturity and to assess whether the fair value of a debt security is less than its amortized cost basis. If the fair value is determined to be less than the amortized cost basis, the company should make the determination of whether the impairment is other-than-temporary. The new rules also call for additional disclosure and are effective for periods ending after June 15, 2009. As of June 30, 2009, our investments in securities totaled only $3.6 million, and our adoption of these rules did not have a material impact on our condensed consolidated financial statements.

In March 2009, the Emerging Issues Task Force (the “EITF”) reached a consensus-for-exposure stating that at the date of issuance, a share-lending arrangement entered into on an entity's own shares in contemplation of a convertible debt offering or other financing is required to be measured at fair value and recognized as a debt issuance cost in the financial statements of the entity. The debt issuance cost shall be amortized using the effective interest method over the life of the financing arrangement as interest cost. The EITF also reached a consensus-for-exposure that the loaned shares are excluded from basic and diluted earnings per share unless default of the share-lending arrangement occurs, at which time the loaned shares would be included in the common and diluted earnings per share calculations. The EITF reached a consensus-for-exposure that this guidance would be effective for fiscal years, and interim periods within those years, beginning after December 15, 2009 and would be applied retrospectively to all arrangements outstanding on the date the issue becomes effective. The consensus-for-exposure has been ratified by the FASB, the comment period has passed and the FASB is currently considering comments received on the draft. We currently are assessing the impact of this development on our convertible senior notes.

In June 2008, the FASB ratified a consensus reached by the EITF on the determination of whether an equity-linked financial instrument (or embedded feature) is indexed to an entity's own stock. After considering these new rules, we re-affirmed our conclusion reached in 2005 that we are not required to bifurcate and separately account for any of the embedded features within our convertible senior notes.

Also in June 2008, the FASB issued new rules addressing whether unvested equity-based awards are participating securities and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method described in previously issued accounting rules. These new rules were effective for us January 1, 2009, and all prior period earnings per share data presented in financial statements have been adjusted retrospectively to conform to the new rules. See Note 12, “Net Income Attributable to Controlling Interests Per Common Share,” for further information regarding the computation of earnings per share.

In May 2008, the FASB issued new rules addressing convertible instruments that may be settled in cash upon conversion (including partial cash settlement). These rules address instruments commonly referred to as Instrument C type instruments. Those instruments essentially require the issuer to settle the principal amount in cash and the conversion spread in cash or net shares at the issuer’s option.

Table of Contents

These rules are effective for fiscal periods beginning after December 15, 2008, did not permit early application, and are required to be applied retrospectively to all periods presented. Our January 1, 2009 adoption of these rules resulted in an increase in shareholders' equity of $56.1 million. See the table below for a roll-forward of the impacts of our adoption of these rules.

In December 2007, the FASB issued new accounting rules that significantly changed the accounting for business combinations. Under these rules, an acquiring entity is required, with limited exceptions, to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value. The rules change the accounting treatment for certain specific items, including:

- Acquisition costs generally are expensed as incurred;
- Noncontrolling interests (formerly known as minority interests) are valued at fair value at the acquisition date;
- Acquired contingent liabilities are recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under previously existing rules for non-acquired contingencies;
- In-process research and development is recorded at fair value as an indefinite-lived intangible asset at the acquisition date;
- Restructuring costs associated with a business combination are generally expensed subsequent to the acquisition date; and
- Changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally affect income tax expense.

The new rules also include a substantial number of new disclosure requirements. They apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, and earlier adoption was prohibited. While the new rules significantly affect the way that we will account for future acquisitions, we adopted them on January 1, 2009 with no material effects on our consolidated results of operations, financial position or cash flows.

Also in December 2007, the FASB issued new accounting requirements that establish new accounting and reporting standards for the noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. Specifically, these rules require the recognition of any noncontrolling interests (minority interests) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interests is included in consolidated net income on the face of the income statement. The rules also clarify that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, the rules require that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss is measured using the fair value of the noncontrolling equity investment on the deconsolidation date. The rules also include expanded disclosure requirements regarding the interests of the parent and its noncontrolling interests. These new rules are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, and earlier adoption was prohibited. We adopted these rules on January 1, 2009 with no material effects (other than the effects of reclassification of our noncontrolling interests as a component of equity) on our consolidated results of operations, financial position or cash flows.

12

Table of Contents

The following details (in thousands, except per share data) the effects of retrospective application of the new accounting rules concerning Instrument C convertible debt and noncontrolling interests:

	As originally reported	Retrospective application of Instrument C convertible debt rules	Retrospective application of noncontrolling interests rules	As adjusted
Additional paid-in capital (as of December 31, 2008)	$413,857	$ 108,714	$ —	$522,571
Retained earnings (as of December 31, 2008)	$505,728	$ (52,579)	$ —	$453,149
Total equity (as of December 31,2008)	$665,844	$ 56,135	$ 24,878	$746,857
Loss from continuing operations (for the three months ended June 30, 2008) (1)	$(42,906)	$ (10,762)	$ (518)	$(54,186)
Net loss (for the three months ended June 30, 2008)	$(44,920)	$ (10,762)	$ (518)	$(56,200)
Loss from continuing operations attributable to controlling interests per common share (for the three months ended June 30, 2008)—basic (1)	$(0.92)	$ (0.21)	$ —	$(1.13)
Loss from continuing operations attributable to controlling interests per common share (for the three months ended June 30, 2008)—diluted (1)	$(0.92)	$ (0.21)	$ —	$(1.13)
Net loss attributable to controlling interests per common share (for the three months ended June 30, 2008)—basic	$(0.96)	$ (0.21)	$ —	$(1.17)
Net loss attributable to controlling interests per common share (for the three months ended June 30, 2008)—diluted	$(0.96)	$ (0.21)	$ —	$(1.17)
Loss from continuing operations (for the six months ended June 30, 2008) (1)	$(37,788)	$ (12,307)	$ 1,501	$(48,594)
Net loss (for the six months ended June 30, 2008)	$(42,452)	$ (12,307)	$ 1,501	$(53,258)
Loss from continuing operations attributable to controlling interests per common share (for the six months ended June 30, 2008)—basic (1)	$(0.81)	$ (0.24)	$ —	$(1.05)
Loss from continuing operations attributable to controlling interests per common share (for the six months ended June 30, 2008)—diluted (1)	$(0.81)	$ (0.24)	$ —	$(1.05)
Net loss attributable to controlling interests per common share (for the six months ended June 30, 2008)—basic	$(0.91)	$ (0.24)	$ —	$(1.15)
Net loss attributable to controlling interests per common share(for the six months ended June 30, 2008)—diluted	$(0.91)	$ (0.24)	$ —	$(1.15)

(1) Prior period “As originally reported” amounts have been restated to report the impact of discontinued operations.

3. Discontinued Operations

In the May 2009, we discontinued our Retail Micro-Loans segment’s Arkansas operations based on ongoing regulatory opposition that we faced within that state; as such, our Arkansas retail micro-loan results of operations have been classified as discontinued operations for all periods presented and the remaining assets (principally net loans and fees receivable upon which we are collecting) and liabilities of these operations are identified as discontinued assets and liabilities on our condensed consolidated balance sheet. Reflecting both our discontinued Arkansas operations, as well as those of other Retail Micro-Loan segment states that we discontinued in prior reporting periods, the components (in thousands) of our discontinued operations are as follows:

Table of Contents

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Net interest income, fees and related income on non-securitized earning assets	$ 375	$ 3,353	$ 1,684	$ 7,647
Other operating expense	863	5,680	2,021	12,920
Estimated loss upon sale	2,779	771	2,779	771
Goodwill impairment	3,483	—	3,483	1,132
Loss before income taxes	(6,750)	(3,098)	(6,599)	(7,176)
Income tax benefit	2,363	1,084	2,310	2,512
Net loss	$ (4,387)	$ (2,014)	$ (4,289)	$ (4,664)

4. Segment Reporting

We operate primarily within one industry consisting of five reportable segments by which we manage our business. Our five reportable segments are: Credit Cards; Investments in Previously Charged-Off Receivables; Retail Micro-Loans; Auto Finance; and Other. We measure the profitability of our reportable segments based on their income after allocation of specific costs and corporate overhead. Overhead costs are allocated based on headcounts and other applicable measures to better align costs with the associated revenues, and there are no charges against segment operations for the internal (i.e., non-third-party) costs of capital that we have allocated to the segments. Summary operating segment information (in thousands) is as follows:

Three Months Ended June 30, 2009	Credit Cards	Investments in Previously Charged-Off Receivables	Retail Micro-Loans	Auto Finance	Other	Total
Net interest income, fees and related income (loss) on non-securitized earning assets	$ (6,268)	$ 3,743	$ 14,118	$ 9,414	$ 10,565	$ 31,572
Total other operating (loss) income	$ (111,950)	$ 27	$ —	$ 90	$ 1	$ (111,832)
(Loss) income from continuing operations before income taxes	$ (176,765)	$ (7,049)	$ (16,549)	$ (6,165)	$ 4,773	$ (201,755)
Loss from discontinued operations before income taxes	$ —	$ —	$ (6,750)	$ —	$ —	$ (6,750)
Loans and fees receivable, gross	$ 1,385	$ —	$ 33,492	$ 325,854	$ 28,045	$ 388,776
Loans and fees receivable, net	$ 1,039	$ —	$ 27,811	$ 260,968	$ 19,413	$ 309,231
Total assets	$ 609,806	$ 68,386	$ 66,793	$ 300,349	$ 61,021	$ 1,106,355

Three Months Ended June 30, 2008	Credit Cards	Investments in Previously	Retail Micro-Loans	Auto Finance	Other	Total

		Charged-Off Receivables				
Net interest income, fees and related income (loss) on non-securitized earning assets	$ (5,353)	$ 11,094	$ 14,728	$ 19,857	$7,052	$47,378
Total other operating income	$ 20,402	$ 225	$ —	$ —	$—	$20,627
Income (loss) from continuing operations before income taxes	$ (88,038)	$ 5,717	$ 2,583	$ (762)	$119	$(80,381)
Loss from discontinued operations before income taxes	$ —	$ —	$ (2,649)	$ —	$(449)	$(3,098)
Loans and fees receivable, gross	$ 30,842	$ —	$ 31,912	$ 387,137	$18,981	$468,872
Loans and fees receivable, net	$ 25,668	$ —	$ 26,934	$ 317,153	$13,673	$383,428
Total assets	$ 1,208,792	$ 38,299	$ 97,902	$ 395,595	$65,345	$1,805,933

Table of Contents

Six Months Ended June 30, 2009	Credit Cards	Investments in Previously Charged-Off Receivables	Retail Micro-Loans	Auto Finance	Other	Total
Net interest income, fees and related income (loss) on non-securitized earning assets	$ (11,884)	$ 7,948	$ 28,492	$ 27,998	$19,349	$71,903
Total other operating (loss) income	$ (220,937)	$ 55	$ —	$ 403	$1	$(220,478)
(Loss) income from continuing operations before income taxes	$ (354,790)	$ (9,377)	$ (17,627)	$ (4,135)	$8,331	$(377,598)
Loss from discontinued operations before income taxes	$ —	$ —	$ (6,599)	$ —	$—	$(6,599)
Loans and fees receivable, gross	$ 1,385	$ —	$ 33,492	$ 325,854	$28,045	$388,776
Loans and fees receivable, net	$ 1,039	$ —	$ 27,811	$ 260,968	$19,413	$309,231
Total assets	$ 609,806	$ 68,386	$ 66,793	$ 300,349	$61,021	$1,106,355

Six Months Ended June 30, 2008	Credit Cards	Investments in Previously Charged-Off Receivables	Retail Micro-Loans	Auto Finance	Other	Total
Net interest income, fees and related income (loss) on non-securitized earning assets	$ (13,256)	$ 30,031	$ 30,925	$ 35,669	$9,213	$92,582
Total other operating income	$ 134,767	$ 438	$ —	$ 196	$—	$135,401
Income (loss) from continuing operations before income taxes	$ (87,979)	$ 19,290	$ 6,408	$ (4,522)	$(3,680)	$(70,483)
Loss from discontinued operations before income taxes	$ —	$ —	$ (6,227)	$ —	$(949)	$(7,176)
Loans and fees receivable, gross	$ 30,842	$ —	$ 31,912	$ 387,137	$18,981	$468,872
Loans and fees receivable, net	$ 25,668	$ —	$ 26,934	$ 317,153	$13,673	$383,428
Total assets	$ 1,208,792	$ 38,299	$ 97,902	$ 395,595	$65,345	$1,805,933

5. Treasury Stock Transactions

At our discretion, we use treasury shares to satisfy option exercises and restricted stock vesting, and we use the cost approach when accounting for the repurchase and reissuance of our treasury stock. We reissued treasury shares totaling 8,006 and 111,644 during the three and six months ended June 30, 2009 at gross costs of $0.1 million and $2.0 million, respectively, in satisfaction of restricted stock vestings. We also effectively purchased shares totaling 2,939 and 36,888 during the three and six months ended June 30, 2009 at a gross cost of $0.01 million and $0.11 million, respectively, by having employees who were vesting in their restricted stock grants exchange a portion of their stock for our payment of required minimum tax withholdings.

6. Investments in Equity-Method Investees

In the following tables, we summarize (in thousands) combined balance sheet and results of operations data for our equity-method investees:

	As of June 30, 2009	As of December 31, 2008
Securitized earning assets	$ 60,819	$ 116,510
Total assets	$ 62,345	$ 118,962
Total liabilities	$ 1,565	$ 1,967
Members’ capital	$ 60,779	$ 116,995

15

Table of Contents

	For the Three Months Ended June 30, 2009	For the Three Months Ended June 30, 2008	For the Six Months Ended June 30, 2009	For the Six Months Ended June 30, 2008
Net interest income, fees and related income on non-securitized earning assets	$ —	$ —	$ —	$ 1
Fees and related (loss) income on securitized earning assets	$ (22,841)	$ 15,929	$ (31,011)	$ 33,231
Total other operating (loss) income	$ (21,745)	$ 18,210	$ (28,605)	$ 37,866
Net (loss) income	$ (15,359)	$ 17,055	$ (23,000)	$ 35,649

In May 2009, we recognized a gain of $21.0 million that is separately classified on our condensed consolidated statement of operations associated with our buy-out of all other members of our then-longest standing equity-method investee. Subsequent to this buy-out event, we have included the operations of this former equity-method investee and its underlying assets and liabilities within our consolidated results of operations and condensed consolidated balance sheet items, as opposed to the income from equity-method investees and investment in equity-method investee categories.

7. Securitizations and Structured Financings

As of June 30, 2009, substantially all of our credit card receivables had been sold to securitization trusts. Within this Report, we refer to such transfers of financial assets to off-balance-sheet securitization trusts as "securitizations," as contrasted with our use of the term "structured financings" to refer to non-recourse, on-balance-sheet debt financings.

Securitizations

Our credit card receivables securitization transactions do not affect the relationship we have with our customers, and we continue to service the securitized credit card receivables. Our ownership of retained interests in our securitized credit card receivables, the guarantee and note purchase agreements with respect to securitizations of acquired credit card receivables portfolios as described in Note 11, "Commitments and Contingencies," and our obligation to service securitized receivables represent our only continuing involvement with our securitized credit card receivables.

The table below summarizes (in thousands) our securitization activities for the periods presented. As with other tables included herein, it does not include the securitization activities of our equity-method investees:

	For the Three Months Ended June 30, 2009	For the Three Months Ended June 30, 2008	For the Six Months Ended June 30, 2009	For the Six Months Ended June 30, 2008
Gross amount of receivables securitized at period end	$ 1,984,497	$ 3,002,547	$ 1,984,497	$ 3,002,547
Proceeds from new transfers of financial assets to securitization trusts	$ 213,102	$ 362,939	$ 304,728	$ 749,926
Proceeds from collections reinvested in revolving-period securitizations	$ 148,443	$ 371,482	$ 275,462	$ 789,899
Excess cash flows received on retained interests	$ 24,826			