



# ANNUAL REPORT

2006



Helping business...process.

## TABLE OF CONTENTS

|  | <b><u>Page</u></b> |
|--|--------------------|
| <b>Description of Business</b>   | 3                  |
| <b>Risk Factors</b>  | 17                 |
| <b>Properties</b>  | 28                 |
| <b>Legal Proceedings</b>   | 28                 |
| <b>Executive Officers and Directors</b>  | 30                 |
| <b>Selected Financial Data</b>   | 33                 |
| <b>Management's Discussion and Analysis of Financial Condition and Results of Operations</b> | 34                 |
| <b>Index to Consolidated Financial Statements</b>  | F-1                |

As used in this Annual Report, unless the context otherwise requires, “we,” “us,” “our,” “Company” or “NCO” refers to NCO Group, Inc., and its subsidiaries.

## **Forward-Looking Statements**

Certain statements included in this Annual Report, including without limitation statements in “Description of Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” other than statements of historical fact, are forward-looking statements (as such term is defined in the Securities Exchange Act of 1934, and the regulations thereunder), which are intended to be covered by the safe harbors created thereby. Forward-looking statements include, without limitation, statements as to:

- the Company’s expected future results of operations;
- the Company’s growth strategy;
- fluctuations in quarterly operating results;
- the integration of acquisitions;
- the final outcome of the Company’s litigation with its former landlord;
- the effects of terrorist attacks, war and the economy on the Company’s business;
- expected increases in operating efficiencies;
- anticipated trends in the business process outsourcing industry, referred to as BPO;
- estimates of future cash flows and allowances for impairments of purchased accounts receivable;
- estimates of goodwill impairments and amortization expense of other intangible assets;
- the effects of legal proceedings, regulatory investigations and tax examinations;
- the effects of changes in accounting pronouncements; and
- statements as to trends or the Company’s or management’s beliefs, expectations and opinions.

The words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “plan,” “will,” “would,” “should,” “guidance,” “potential,” “continue,” “project,” “forecast,” “confident,” and similar expressions are typically used to identify forward-looking statements. These statements are based on assumptions and assessments made by the Company’s management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. Any forward-looking statements are not guarantees of our future performance and are subject to risks and uncertainties and may be affected by various factors that may cause actual results, developments and business decisions to differ materially from those in the forward-looking statements. Some of the factors that may cause actual results, developments and business decisions to differ materially from those contemplated by such forward-looking statements include the risk factors discussed under the heading “Risk Factors” and the following:

- the risk that the Company will not be able to implement its growth strategy as planned;
- risks associated with growth and acquisitions;
- the risk that the Company will not be able to realize operating efficiencies in the integration of its acquisitions;
- fluctuations in quarterly operating results;
- risks related to the timing of contracts;
- risks related to purchased accounts receivable;

- risks related to possible impairment of goodwill and other intangible assets;
- risks related to union organizing efforts at the Company's facilities;
- risks associated with technology;
- risks related to the implementation of the Company's Enterprise Resource Planning system;
- risks related to the final outcome of the Company's litigation with its former landlord;
- risks related to litigation, regulatory investigations and tax examinations;
- risks related to past or possible future terrorist attacks;
- risks related to natural disasters or the threat or outbreak of war or hostilities;
- risks related to the domestic and international economies;
- the risk that the Company will not be able to improve margins;
- risks related to the Company's international operations;
- risks related to the availability of qualified employees, particularly in new or more cost-effective locations;
- risks related to currency fluctuations;
- risks related to reliance on independent telecommunications service providers;
- risks related to concentration of the Company's clients in the financial services, telecommunications and healthcare sectors;
- risks related to potential consumer resistance to outbound services;
- risks related to the possible loss of key clients;
- risks related to changes in government regulations affecting the teleservices and telecommunications industries;
- risks related to competition from other outside providers of BPO services and the in-house operations of existing and potential clients; and
- risks related to competition with other purchasers of accounts receivable.

On November 15, 2006, NCO Group, Inc. was acquired by Collect Holdings, Inc., an entity controlled by One Equity Partners and its affiliates, a private equity investment fund, with participation by Michael J. Barrist, Chairman, President and Chief Executive Officer of NCO Group, Inc., certain other members of executive management and other co-investors, referred to as the Transaction. After the closing of the Transaction, NCO Group, Inc.'s common stock was no longer publicly traded. Subsequent to the date of the Transaction, NCO Group, Inc. was merged with and into Collect Holdings, Inc., and Collect Holdings, Inc. was renamed NCO Group, Inc. In addition to the factors noted above, the Company believes that the following factors with respect to the Transaction could cause actual results to differ materially from those discussed in the forward-looking statements:

- risks related to the Company's substantial indebtedness incurred in connection with the Transaction;
- risks related to the potential difficulty in retaining employees as a result of the Transaction; and
- risks related to the disruption of operations caused by the Transaction.

The Company can give no assurance that any of the events anticipated by the forward-looking statements will occur or, if any of them does, what impact they will have on our results of operations and financial condition. The Company disclaims any intent or obligation to publicly update or revise any forward-looking statements, regardless of whether new information becomes

available, future developments occur or otherwise.

## **Description of Business**

### **General**

On November 15, 2006, NCO Group, Inc. was acquired by and became a wholly owned subsidiary of Collect Holdings, Inc., an entity controlled by One Equity Partners and its affiliates, a private equity investment fund, with participation by Michael J. Barrist, Chairman, President and Chief Executive Officer of NCO Group, Inc., certain other members of executive management and other co-investors, referred to as the Transaction. Collect Holdings, Inc. was subsequently renamed NCO Group, Inc.

We are a holding company and conduct substantially all of our business operations through our subsidiaries. NCO is a leading provider of business process outsourcing services, referred to as BPO, primarily focused on accounts receivable management, referred to as ARM, and customer relationship management, referred to as CRM. Our outsourcing solutions include ARM, contact center support and back office support services for a diversified customer base. We provide a wide range of ARM services to our clients by utilizing an extensive technological infrastructure. Although traditional ARM services have focused on the recovery of delinquent accounts, we also engage in the recovery of current accounts receivable and early stage delinquencies (generally, accounts that are 180 days or less past due). Our CRM services allow our clients to strengthen their customer relationships by providing a high level of support to their customers and generate incremental sales by acquiring new customers. We support essential business functions across key portions of the customer life cycle including acquisition, growth, care, resolution and retention. The primary market sectors we support in our BPO business are financial services, telecommunications, healthcare, retail and commercial, utilities, education, transportation/logistics, technology and government. We also purchase and manage past due consumer accounts receivable from consumer creditors such as banks, finance companies, retail merchants, utilities, healthcare companies, and other consumer-oriented companies.

Our extensive industry knowledge, technological expertise, management depth, international scale, broad service offerings and long-standing client relationships enable us to deliver customized solutions that help our clients reduce their operating costs, increase cash flow, and improve their customers' experience. We provide our services through our customer-driven model that provides optimal performance, leading-edge technology, proven efficiency and quality, to a wide range of clients in North America and abroad. We have approximately 24,000 full and part-time employees (including approximately 1,400 non-employee personnel utilized through subcontractors) who provide our services through our network of over 100 offices in nine countries.

### **Industry Background**

Companies are outsourcing many essential, non-core business functions to focus on revenue-generating activities and core competencies, reduce costs and improve productivity and service levels. In particular, many large corporations are recognizing the advantages of outsourcing accounts receivable management and customer service and support. This trend is being driven by a number of industry-specific factors, including:

- an increase in the complexity of collection and other customer service processes, which requires sophisticated call management and database systems for efficient operations;

- the lack of expertise, resources and infrastructure necessary to provide optimal customer support due to the growing scope and complexity of such activities; and
- a trend in certain industries to outsource essential, non-core functions due to competitive pressures, regulatory considerations and/or required capital expenditures.

Gartner Dataquest estimates in its 2005 Report that the global market for BPO services grew from approximately \$86 billion in 2001 to approximately \$121 billion in 2005 in terms of revenue and projects a nine percent compounded annual growth rate from 2005 through 2009. We currently focus on the ARM and CRM segments of the BPO market. Both of these industry segments have experienced growth in recent years, driven by the increasing penetration of outsourcing services, the continuing growth in consumer and commercial debt, an increased focus on building long-term customer relationships and a shift away from large scale in-house implementations to BPO.

The BPO industry is highly fragmented in the U.S. The leading providers are large multinational companies. We believe that many smaller competitors have insufficient capital to expand and invest in technology and are unable to meet the geographic coverage, and regulatory requirements and quality standards demanded by businesses seeking to outsource their essential, non-core business functions.

## **Business Strategy**

**Expand our relationships with clients** – An integral component of our growth strategy is focused on the expansion of existing client relationships. We plan to continue to grow these relationships and the resulting opportunities in both scale and depth. We believe these relationships will continue to transition from vendor relationships, focusing on the operational delivery of services, to strategic partnerships focused on long-term, goal-oriented delivery of services.

**Expand internationally** – We believe that the BPO industry is gaining widespread acceptance throughout Canada, Europe and the Asia-Pacific region. Our international expansion strategy is designed to capitalize on each of these markets in the near term, as well as continue to develop access to lower-cost foreign labor. We believe that we are one of the largest providers of BPO services in Canada. We also have a growing presence in Europe. In 2006, we entered two new markets through acquisitions. We purchased Australian Receivables Limited, a provider of ARM services in Australia and Star Contact (BVI) Ltd., a provider of multi-lingual CRM services based in Panama. Also in 2006, we continued to expand our operations in Barbados. We expect to further penetrate these markets through increased sales of ARM and CRM services, as well as through the pursuit of accounts receivable purchasing opportunities. Additionally, we expect to pursue direct investments, strategic alliances and partnerships as well as further explore acquisitions in these markets and other markets. In addition, we are in the process of exploring new opportunities in other labor markets such as Eastern Europe, Central America and the Caribbean.

**Continue to pursue debt purchasing opportunities** – Since 1999, we have expanded our portfolio purchase platform. In 2005, we expanded our presence in the medical and utilities industries, as well as with telecommunication companies and credit card issuers. We purchased an aggregate of \$111.5 million (in terms of cost) of portfolios of accounts receivable in 2006. Our strategic plan focuses on purchasing larger portfolios of accounts receivable, for which we currently believe there is less competition.

We intend to continue to pursue larger debt purchasing opportunities. Through enhanced analysis of portfolio performance and utilizing the collections experience of our ARM business for similar classes of debt, we have been able to target profitable opportunities within the market for

available U.S. portfolios. In order to facilitate our purchase of large portfolios of accounts receivable, we have an agreement with a lender to finance such purchases on a nonrecourse basis. While our principal portfolios continue to be larger credit card and similar U.S.-based consumer receivables, our growth strategy includes the expansion into telecommunications, utilities, medical and international purchase opportunities. In 2005, we also began a process of identifying and selling older, unresolved accounts that we believe have a low probability of collection and/or that could be sold currently for more than we can collect over time, net of servicing costs.

**Enhance our operating margins** – We intend to continue pursuing the following initiatives to increase profitability:

- standardization of systems and practices;
- consolidation of facilities;
- automation of clerical functions;
- utilization of near shore and offshore labor;
- use of statistical analysis to improve performance and reduce operating expenses; and
- leveraging our size and international presence.

**Continuously improve business processes** – We intend to continue developing and enhancing our technology and infrastructure with initiatives that improve the efficiency of our operations and enhance client service. Examples of our recent initiatives include:

• *Pattern recognition system:* In December 2005, we acquired a pattern recognition system designed to determine the patterns and profiles that precede customer decisions such as purchase or defection. Leveraging predictive analytic technologies increases the ability to predict customers' behaviors, thus improving the results of the outsourced solutions we provide to our clients, as well as improving our purchased portfolio analytics.

• *Enterprise resource planning system:* In 2005, we converted our financial, human resources and CRM platforms to an integrated enterprise resource planning (“ERP”) platform. This implementation should enable us to more efficiently manage the changing requirements of our industry and clients, and provide critical business information to operate our business more effectively.

• *Enhanced data management and analytics:* We have implemented both client-specific and pooled segmentation models to focus better our collections efforts. These models, coupled with iterative segment-based treatment testing, provide benefits by reducing operating expense and increasing collection revenues.

• *Online access for subcontractor agencies:* Leveraging the technology used to service our Attorney Network System, which brings us online with over 100 law firms across the United States, we have expanded this system to also support the data exchange requirements with other agencies we utilize to service accounts. These agencies are now able to receive, process, and return updates using the latest web server technology.

• *Enhanced data security:* We continue to deploy both physical and system security enhancements to help ensure ongoing protection and privacy of NCO and client data as well as network and systems hardening. We incorporate sophisticated password, access and authentication controls, and have emphasized security awareness training programs.

**Pursue strategic acquisition opportunities** – We have developed a disciplined approach to acquisitions. We believe our approach enables us to efficiently integrate acquired businesses, personnel and facilities into our existing technology platform, personnel matrix and facilities. By leveraging our shared services and infrastructure, we facilitate the realization of cost synergies and growth of sales and earnings. We intend to evaluate and pursue strategic acquisitions on an opportunistic basis as they become available.

## **Our Services**

We provide the following BPO services:

### **Accounts Receivable Management and Collection**

We provide a wide range of ARM services to our clients by utilizing an extensive technological infrastructure. Although traditional ARM services have focused on the recovery of delinquent accounts, we also engage in the recovery of current accounts receivable and early stage delinquencies (generally, accounts that are 180 days or less past due). We generate approximately 59 percent of our ARM revenue from the recovery of delinquent accounts receivable on a contingency fee basis. In addition, we generate revenue from fixed fees for certain accounts receivable management and collection and other related services.

ARM services typically include the following activities:

**Engagement Planning.** We customize solutions for our clients based on a number of factors, including account size and demographics, the client's specific requirements and management's estimate of the collectibility of the account. We integrate our standard processes for accounts receivable management and collection, developed from decades of accumulated experience, to create a customized recovery solution. In many instances, the approach will evolve and change as the relationship with the client develops, and both parties evaluate the most effective means of recovering accounts receivable. Our systematic approach to accounts receivable management and collection removes most decision making from the recovery staff and is designed to ensure uniform, cost-effective performance.

Once the approach has been defined, we electronically or manually transfer pertinent client data into our information system. When the client's records have been established in our system, we begin the recovery process.

**Account Notification.** We initiate the recovery process by forwarding a preliminary letter that is designed to seek payment of the amount due or open a dialogue with client's customers. This letter also serves as an official notification to each client's customer of his or her rights as required by the Federal Fair Debt Collection Practices Act. We continue the recovery process with a series of mail and telephone notifications. Telephone representatives remind the client's customer of their obligation, inform them that their account has been placed for collection with us and begin a dialogue to develop a payment program.

**Skip Tracing.** In cases where the client's customer's contact information is unknown, we systematically search the U.S. Post Office National Change of Address service, consumer databases, electronic telephone directories, credit agency reports, tax assessor and voter registration records, motor vehicle registrations, military records, and other sources. The geographic expansion of banks, credit card companies, national and regional telecommunications companies, and national hospital chains, along with the mobility of consumers, has increased the demand for

locating the client's customers. Once we have located the client's customer, the notification process can begin.

***First Party Early Stage Delinquency Calls.*** Although companies understand the importance of contacting customers early in the delinquency cycle, some do not possess the resources necessary to sustain consistent and cost-effective outbound telephone campaigns. We provide a customized, service approach to contact our clients' customers and remind them of their obligation to pay their accounts.

We typically conduct reminder calls in the client's name to recently past due customers and courtesy collection calls to more seriously delinquent customers. Our representatives leave courteous messages if telephone contact attempts are unsuccessful after the second day.

***Third Party Collection Services.*** The most common challenges encountered by companies are how to prompt seriously delinquent customers to make payment before they are charged off as uncollectible or to collect the full balance after charge-off. Our third party collection services communicate a sense of urgency to seriously delinquent customers during these periods, reducing net charge-offs and the cost of collection.

***Credit Reporting.*** Credit bureau reporting is used as a collection tool in accordance with NCO's policy, applicable laws, and client guidelines. At a client's request, we will electronically report delinquent accounts to one or more of the national credit bureaus where it will remain for a period of up to seven years. The possible denial of future credit often motivates the resolution of past due accounts.

***Payment Processing.*** After we receive payment from the client's customer, depending on the terms of our contract with the client, we can either remit the amount received minus our fee to the client or remit the entire amount received to the client and subsequently bill the client for our collection services.

***Activity Reports.*** Clients are provided with a system-generated set of customized reports that fully describe all account activity and current status. These reports are typically generated monthly; however, the information included in the report and the frequency that the reports are generated can be modified to meet the needs of the client.

***Quality Tracking.*** We emphasize quality control throughout all phases of the accounts receivable management and collection process. Some clients may specify an enhanced level of supervisory review and others may request customized quality reports. For example, large financial services organizations will typically have exacting performance standards which require sophisticated capabilities, such as documented complaint tracking and specialized software to track quality metrics to facilitate the comparison of our performance to that of our peers.

## **Customer Relationship Management**

Our CRM services allow our clients to strengthen their customer relationships by providing a high level of support to their customers and generate incremental sales by acquiring new customers. We design and implement customized outsourced customer care solutions including the following:

***Customer Care and Retention.*** Our representatives specialize in developing and maintaining the relationships that our clients value. Customer care programs vary depending upon each client's

specific goals, but often include services such as customer development and outbound and inbound calling campaigns. Our representatives handle customer care inquiries such as billing questions, product and service inquiries, and complaint resolution. We also place calls on behalf of clients in welcoming new customers, retaining current customers, delivering notifications and conducting market research or satisfaction surveys. Our programs include specialized training in order to ensure that each representative is a seamless extension of our clients' businesses.

***Customer Acquisition and Sales.*** We support inbound and outbound sales efforts by conducting customized programs designed to acquire new customers, renew current customers, and win back or win over targeted customers. We execute multiple phases of the sales order process, pre- and post-sale, from answering product related questions and making sales presentations to up selling, cross selling and order processing.

***Product and Technical Support.*** In support of the increasing dependence of customers and businesses on technology, prompt and accurate responses to technology inquires, product-related support issues, and service related concerns has become a cornerstone to maintaining high customer satisfaction and achieving retention goals. Our product support services include help desk, troubleshooting, warranty, recall, and upgrade support. We strive for first call resolution and are committed to meeting client service level requirements. We believe that our highly trained customer contact staff is knowledgeable in all components of technical support and help desk related service requirements, and is adept at troubleshooting, evaluation and escalation procedures and resolving complaints quickly and effectively to increase our clients' customer retention and loyalty.

***Interactive Voice Response.*** We use interactive voice response technology to cost-effectively facilitate customer care for our clients. Customers can efficiently obtain account balance information, transfer funds, place an order, check status of an order, pay a bill, or answer a survey. Incoming calls are routed to representatives through systematic call transfer protocols or as a result of a toll-free number being included on customer correspondence. The process is completely automated, and if the caller wants to speak to a representative they can choose to be connected to a live NCO customer service professional. This combination of live and recorded telephone interaction benefits the customer through efficient, 24-hour service, and decreased operating costs.

***Email Management.*** An important component to attracting and retaining customers is easy accessibility. Our email management services allow our clients' customers to communicate with them day or night, 24 hours a day, seven days a week. Our response generation and intelligent routing provide an efficient means to respond to customer needs while increasing our clients' operational effectiveness and decreasing their costs.

***Web Chat.*** We have the ability to communicate with clients' customers through our live Web chat service. Faster than email, our Web chat solution allows customers to interact with agents in real time. We can leverage our Web chat technology to provide customer care, answer product questions, or offer technical support.

***In-Language Contact.*** Our global network of call centers support all major languages, including English, Spanish, French, Arabic, Korean, Hindi, Polish, Russian, Tagalog, and numerous Asian dialects. We have a wealth of experience supporting multilingual programs and can work with clients to meet any language requirement.

***Pattern Recognition System.*** We have a pattern recognition system designed to enhance client results by determining the patterns and profiles that precede customer decisions such as purchase

or defection. Leveraging predictive analytic technologies increases the ability to predict customers' behavior thus improving the results of the outsourced solutions we provide to our clients.

## **Portfolio Management**

Our Portfolio Management business segment purchases, collects and manages portfolios of purchased accounts receivable. These portfolios consist primarily of delinquent consumer accounts receivable. In 2005, we were the second largest direct purchaser of credit card debt in the U.S., according to the May 2006 Nilson Report, an industry news source.

## **Additional Services**

We selectively provide other related services that complement our traditional ARM and CRM businesses and leverage our technological infrastructure. We believe that the following services will provide additional growth opportunities for us:

***Attorney Network Services.*** We coordinate and implement legal collection solutions undertaken on behalf of our clients through the management of nationwide legal resources specializing in collection litigation. Our collection support staff manages the attorney relationships and facilitates the transfer of necessary documentation.

***NCOePayments.*** We provide our clients' customers with multiple secure payment options, accessible via the telephone and the Internet, 24 hours a day, 365 days a year. We also provide contact center solutions utilizing our extranet technology, allowing representatives to take payments directly from the customer.

***Financial Investigative Services.*** We develop the information needed to profile commercial debtors and make decisions affecting extensions of credit. Our investigators uncover background and financial data using resources such as asset and liability searches, background investigations, and chain of title investigations.

***Order Processing.*** We support multiple phases of order processing, including answering product-related questions and making sale presentations, up selling and cross selling, order entry, and providing post-sale support.

***Back Office Support.*** We coordinate customizable back office solutions including billing, payment processing, medical certification, bankruptcies, and accounting.

## **Technology and Infrastructure**

We have implemented a scalable technical infrastructure that can flexibly support growing client volume while delivering a high level of service. Our customer contact centers feature advanced technologies, including predictive dialers, automated call distribution systems, digital switching, digital recording, workforce management systems and customized computer software, including the NCO ACCESS Interface Manager. This is a graphical user interface and computer desktop application we developed for use in large-scale outsourcing engagements that enables data integration, enhanced reporting, representative productivity, implementation speed, and security. As a result, we believe we are able to address outsourced business process activities more reliably and more efficiently than our competitors. Our IT staff is comprised of over 300 employees. We provide our services through the operation of over 100 centers that are electronically linked through an international wide area network.

We maintain disaster recovery contingency plans and have implemented procedures to protect against the loss of data resulting from power outages, fire and other casualties. We believe fast recovery and continuous operation are ensured with multiple redundancies, uninterruptible power supplies and contracted backup and recovery services. We have implemented a security system to protect the integrity and confidentiality of our computer systems and data, and we maintain comprehensive business interruption and critical systems insurance on our telecommunications and computer systems. Our systems also permit secure network access to enable clients to electronically communicate with us and monitor operational activity on a real-time basis. We employ a variety of measures including firewalls, encryption, data access, permissions, and site security to ensure data remains safe and secure.

Our ARM call centers utilize predictive dialers with a total of over 6,700 stations to address our low-balance, high-volume accounts, and our CRM centers utilize approximately 1,300 predictive dialer stations to conduct our clients' outbound calling campaigns. These systems scan our databases, simultaneously initiate calls on all available telephone lines, and determine if a live connection is made. Upon determining that a live connection has been made, the computer immediately switches the call to an available representative and instantaneously displays the associated account record on the representative's workstation. Calls that reach other signals, such as a busy signal, telephone company intercept or no answer, are tagged for statistical analysis and placed in priority recall queues or multiple-pass calling cycles. The system also automates almost all record keeping and follow-up activities including letter and report generation. We believe that our automated method of operations dramatically improves the productivity of our staff.

### **Quality Assurance and Client Service**

We believe a reputation for quality service is critical to acquiring and retaining clients. Therefore, our representatives are supervised, by both NCO and our clients, for strict compliance with client specifications, our policies, and applicable laws and regulations. We regularly measure the quality of our services by capturing and reviewing such information as the amount of time spent talking with clients' customers, level of customer complaints and operating performance. In order to provide ongoing improvement to our telephone representatives' performance and to ensure compliance with our policies and standards, as well as federal, state and local guidelines, quality assurance personnel supervise each telephone representative on a frequent basis and provide ongoing training to the representative based on this review. Our information systems enable us to provide clients with reports on a real-time basis as to the status of their accounts and clients can choose to network with our computer system to access such information directly.

We maintain a client service department to promptly address client issues and questions and alert senior executives of potential problems that require their attention. In addition to addressing specific issues, a team of client service representatives contacts clients on a regular basis in order to establish a close relationship, determine clients' overall level of satisfaction, and identify practical methods of improving their satisfaction.

### **Client Relationships**

Our active client base currently includes over 26,000 companies in the financial services, telecommunications, healthcare, retail and commercial, utilities, education, transportation/logistics, technology, and government sectors. Our 10 largest clients in 2006 accounted for approximately 38 percent of our consolidated revenue. No client accounted for more than 10 percent of our consolidated revenue. While our CRM division relies on revenue from a few key clients, none of

these clients represented more than 10 percent of our consolidated revenue. In 2006, we derived 34.3 percent of our revenue from financial services (which includes the banking and insurance sectors), 23.0 percent from telecommunications companies, 14.6 percent from healthcare organizations, 7.3 percent from retail and commercial entities, 7.0 percent from utilities, 4.9 percent from educational organizations, 4.1 percent from transportation/logistics companies, 4.0 percent from technology companies, and 0.9 percent from government entities, in each case excluding purchased accounts receivable.

We enter into ARM contracts with most of our clients that define, among other things, fee arrangements, scope of services and termination provisions. Clients may usually terminate such contracts on 30 or 60 days notice. In the event of termination, however, clients typically do not withdraw accounts referred to us prior to the date of termination, thus providing us with an ongoing stream of revenue from such accounts, which diminishes over time. Under the terms of our contracts, clients are not required to place accounts with us but do so on a discretionary basis.

Our CRM contracts are generally for terms of up to three years. Contracts are typically terminable by either party upon 60 days notice; however, in some cases, particularly in our longer term inbound contracts which often require substantial capital expenditures on our part, a client may be required to pay us a termination fee in connection with an early termination of the contract.

In addition, certain inbound CRM contracts may contain minimum volume commitments requiring our clients to provide us with agreed-upon levels of calls during the terms of the contracts. Our fees for services rendered under these contracts are based on pre-determined contracted chargeable rates that may include a base rate per minute or per hour plus a higher rate or “bonus” rate if we meet pre-determined objective performance criteria, such as sales generated during a defined period, and may be reduced by any contractual monthly performance penalties to which the client may be entitled. Additionally, we may receive additional discretionary client determined bonuses based upon criteria established by our clients.

Some of our customer contracts provide for limited currency rate protection below certain pre-determined exchange rate levels and limited gain sharing above certain pre-determined exchange rate levels. Such contracts may mitigate certain currency risks, however, there can be no assurance that new contracts will be successfully negotiated with such provisions or that existing contract provisions will result in the reduction of currency risk for such contracts.

On occasion we enter into “forward-flow” agreements for the purchase of accounts receivable from consumer credit grantors. A forward-flow agreement is a commitment to purchase a defined volume of accounts from a seller for a designated period of time at a fixed price.

## **Personnel and Training**

Our success in recruiting, hiring and training a large number of employees is critical to our ability to provide high quality BPO services to our clients. We seek to hire personnel with previous experience in the industry or with experience as telephone representatives. We generally offer internal promotion opportunities and competitive compensation and benefits.

All of our call center personnel receive comprehensive training that consists of three stages: introduction training, behavioral training and functional training. These programs are conducted through a combination of classroom and role-playing sessions. Prior to customer contact, new employees receive one week of training in our operating systems, procedures and telephone techniques and instruction in applicable federal and state regulatory requirements. Our personnel

also receive a wide variety of continuing professional education and on-going refresher training, as well as additional product training on an as-needed basis.

As of December 31, 2006, we had a total of approximately 21,000 full-time employees and 1,600 part-time employees, of which approximately 16,000 are telephone representatives. In addition, as of December 31, 2006, we utilized approximately 535, 655 and 185 telephone representatives through subcontractors in the U.S., India, and Antigua, respectively. We believe that our relations with our employees are good.

Typically our employees are not represented by a labor union; however, in February 2006, our employees in Surrey, British Columbia, Canada voted in favor of joining the B.C Government and Services Employees' Union. A collective agreement was ratified by the employees in the first quarter of 2007. From time to time, our facilities are targeted by union organizers. During May 2006, our Jackson, Michigan facility was the subject of a union campaign from the Teamsters. We are not aware of any union organizing efforts at any of our other facilities.

## **Sales and Marketing**

Our sales force is organized into two functional groups to best match our sales professionals' experience and expertise with the appropriate target market. The commercial sales group consists of approximately 70 telephone sales representatives who specialize in business-to-business BPO solutions for small to mid-sized companies. Our core sales force, composed of approximately 50 sales professionals, is organized by industry and geographical location to ensure the highest level of focus and service to potential and existing business partners. This group is focused on forming and cultivating strategic, long-term partnerships with large, multinational firms in order to maximize outsourcing opportunities via our full suite of BPO services.

We have a Client Relationship Management system that provides tools to support both sales and operations in the management of client relationships from initial identification of a prospect to the care and retention of long-term clients. The module is fully implemented on our IT Operating Platform, and was deployed to NCO sales staff during the first half of 2006.

Our in-house marketing department provides innovative customer contact solutions and sales support by performing a wide range of personalized services such as customer database administration, advertising, marketing campaigns and direct mailings, collateral development, trade show and site visit management, market and competitive research, and more. We also maintain a dedicated team of skilled writers who prepare detailed, professional responses to formal requests for proposals and requests for information.

## **Competition**

The BPO industry is highly competitive. We compete with a large number of ARM providers, including large national corporations such as GC Services LP, IntelliRisk Management Corporation, and Outsourcing Solutions, Inc., as well as many regional and local firms. We also compete with large CRM providers such as Convergys Corporation, ICT Group, SITEL Corporation, TeleTech Holdings, Inc., and West Corporation. Some of our competitors may offer more diversified services and/or operate in broader geographic areas than we do. In addition, many companies perform the BPO services offered by us in-house. Moreover, many larger clients retain multiple outsourcing providers, which exposes us to continuous competition in order to remain a preferred vendor. We believe that the primary competitive factors in obtaining and retaining clients

are the ability to provide customized solutions to a client's requirements, personalized quality service, sophisticated call and information systems, and a competitive price.

Our Portfolio Management segment competes with other purchasers of delinquent consumer accounts receivable, such as Asset Acceptance Capital Corp., Asta Funding, Inc., Encore Capital Group, Inc. and Portfolio Recovery Associates, Inc. The purchased accounts receivable business has become increasingly competitive over the past few years, with several new companies entering the market. While the number of portfolios available for sale has increased somewhat, we believe the demand outweighs the supply, which has caused pricing to increase. Our competitors may have greater access to financing sources to purchase portfolios than we do, and may be able to outbid us on available portfolios. We believe the primary competitive factor in this business is the ability to purchase portfolios at reasonable prices.

## **Regulation**

### **Accounts Receivable Management and Collection**

The ARM industry in the United States is regulated both at the federal and state level. The Federal Fair Debt Collection Practices Act, referred to as the FDCPA, regulates any person who regularly collects or attempts to collect, directly or indirectly, consumer debts owed or asserted to be owed to another person. The FDCPA establishes specific guidelines and procedures that debt collectors must follow in communicating with consumer debtors, including the time, place and manner of such communications. Further, it prohibits harassment or abuse by debt collectors, including the threat of violence or criminal prosecution, obscene language or repeated telephone calls made with the intent to abuse or harass. The FDCPA also places restrictions on communications with individuals other than consumer debtors in connection with the collection of any consumer debt and sets forth specific procedures to be followed when communicating with such third parties for purposes of obtaining location information about the consumer. Additionally, the FDCPA contains various notice and disclosure requirements and prohibits unfair or misleading representations by debt collectors. We are also subject to the Fair Credit Reporting Act, which regulates the consumer credit reporting industry and which may impose liability on us to the extent that the adverse credit information reported on a consumer to a credit bureau is false or inaccurate. The Federal Trade Commission, referred to as the FTC, has the authority to investigate consumer complaints against debt collection companies and to recommend enforcement actions and seek monetary penalties. The ARM business is also subject to state regulation. Some states require that we be licensed as a debt collection company. We believe that we currently hold applicable state licenses from all states where required.

We provide services to healthcare clients that are considered "covered entities" under the Health Insurance Portability and Accountability Act of 1996, referred to as HIPAA. As covered entities, our clients must comply with the standards for privacy, transaction and code sets, and data security. Under HIPAA, we are considered a "business associate," which requires that we protect the security and privacy of "protected health information" provided to us by our clients for the collection of payments for healthcare services. We believe that we operate in compliance with all applicable standards under HIPAA in all material respects.

The collection of accounts receivable by collection agencies in Canada is regulated at the provincial and territorial level in substantially the same fashion as is accomplished by federal and state laws in the United States. The manner in which we conduct the business of collecting accounts is subject, in all provinces and territories, to established rules of common law or civil law

and statute. Such laws establish rules and procedures governing the tracing, contacting and dealing with debtors in relation to the collection of outstanding accounts. These rules and procedures prohibit debt collectors from engaging in intimidating, misleading and fraudulent behavior when attempting to recover outstanding debts. In Canada, our collection operations are subject to licensing requirements and periodic audits by government agencies and other regulatory bodies. Generally, such licenses are subject to annual renewal. We believe that we hold all necessary licenses in those provinces and territories that require them.

In addition, the ARM industry is regulated in the United Kingdom and Europe, including licensing requirements. We believe we hold all necessary licenses required in the United Kingdom and Europe. If we expand our international operations, we may become subject to additional government control and regulation in other countries, which may be more onerous than those in the United States.

Several of the industries served by us are also subject to varying degrees of government regulation. Although compliance with these regulations is generally the responsibility of our clients, we could be subject to various enforcement or private actions for our failure or the failure of our clients to comply with such regulations.

## **Customer Relationship Management**

### *U.S. Federal and State Regulation*

In the United States, there are two major federal laws that specifically address telemarketing, the Telephone Consumer Protection Act, referred to as TCPA, which authorized the Federal Communications Commission, referred to as the FCC, to adopt rules implementing the TCPA, and the Telemarketing and Consumer Fraud and Abuse Prevention Act, referred to as the Fraud Prevention Act, which authorized the FTC, to adopt the Telemarketing Sales Rule, referred to as the TSR. Over the past few years, the TSR has been amended to include several new restrictions on telemarketing activities. In addition, the states have various regulatory restrictions and requirements for telemarketing companies.

The TCPA places restrictions on unsolicited automated telephone calls to residential telephone subscribers by means of automatic telephone dialing systems, prerecorded or artificial voice messages and telephone fax machines. In addition, the regulations require CRM firms to develop a “do not call” list and to train their CRM personnel to comply with these restrictions. The TCPA creates a right of action for both consumers and state attorneys general. A court may award damages or impose penalties of \$500 per violation, which may be trebled for willful or knowing violations. Currently, we train our service representatives to comply with the regulations of the TCPA. On March 11, 2003, the Do-Not-Call Implementation Act, referred to as the Do-Not-Call Act, was signed into law. The Do-Not-Call Act required the FCC to issue final rules under the TCPA to maximize the consistency of the TCPA with the FTC’s December 18, 2002 amendments to the TSR, as discussed below. Accordingly, on July 3, 2003, the FCC issued rules regarding the national do-not-call registry, call abandonment and caller ID requirements.

The FTC regulates both general sales practices and telemarketing specifically and has broad authority to prohibit a variety of advertising or marketing practices that may constitute “unfair or deceptive acts or practices.” Pursuant to its general enforcement powers, the FTC can obtain a variety of types of equitable relief, including injunctions, refunds, disgorgement, the posting of bonds and bars from continuing to do business for a violation of the acts and regulations it enforces.

The FTC also administers the Fraud Prevention Act under which the FTC has issued the TSR prohibiting a variety of deceptive, unfair or abusive practices in direct telephone sales. Generally, these rules prohibit misrepresentations of the cost, quantity, terms, restrictions, performance or characteristics of products or services offered by telephone solicitation or of refund, cancellation or exchange policies. The rules also regulate the use of prize promotions in direct telephone sales to prevent deception and require that a telemarketer identify promptly and clearly the seller on whose behalf the CRM representative is calling, the purpose of the call, the nature of the goods or services offered and that no purchase or payment is necessary to win a prize. The regulations also require that providers of services maintain records on various aspects of their businesses.

On December 18, 2002, the FTC amended the TSR. The major change was the creation of a centralized national “do not call” registry. Federal enforcement of the National Do Not Call Registry began on October 1, 2003. A consumer who receives a telemarketing call despite being on the registry can file a complaint with the FTC, either online or by calling a toll free number. Violators could be fined up to \$11,000 per incident. In addition, the amended TSR restricts call abandonment (with certain safe harbors) and unauthorized billing. Further, as of January 29, 2004, the amended TSR requires telemarketers to transmit their telephone numbers and, if possible, their names to consumers’ “caller id” services.

At the state level, most states have enacted consumer protection statutes prohibiting unfair or deceptive acts or practices as they relate to telemarketing sales. For example, telephone sales in certain states are not final until a written contract is delivered to and signed by the buyer, and such a contract often may be canceled within three business days. At least one state also prohibits parties conducting direct telephone sales from requesting credit card numbers in certain situations, and several other states require certain providers of such services to register annually, post bonds or submit sales scripts to the state’s attorney general. Under these general enabling statutes, depending on the willfulness and severity of the violation, penalties can include imprisonment, fines and a range of equitable remedies such as consumer redress or the posting of bonds before continuing in business.

Additionally, some states have enacted laws and others are considering enacting laws targeted at direct telephone sales practices. Some examples include laws regulating electronic monitoring of telephone calls and laws prohibiting any interference by direct telephone sales with “caller id” devices. Most of these statutes allow a private right of action for the recovery of damages or provide for enforcement by state agencies permitting the recovery of significant civil or criminal penalties, costs and attorneys’ fees. There can be no assurance that any such laws, if enacted, will not adversely affect or limit our current or future operations.

To date, 16 states have established statewide “do not call” lists. Twenty-five states have opted to use the FTC’s Do Not Call list as the official state list.

The industries we serve are also subject to government regulation, and, from time to time, bills are introduced in Congress, which, if enacted, could affect our operations. We, and our employees who sell insurance products, are required to be licensed by various state and provincial insurance commissions for the particular type of insurance product to be sold and are required to participate in regular continuing education programs.

Telecommunications is another industry we serve that is subject to government regulation. For example, “slamming” is the illegal practice of changing a consumer’s telephone service without permission. The FCC has promulgated regulations regarding slamming rules that apply solely to

the telecommunications carrier and not the telemarketer or the independent party verifying the service change. However, some state slamming rules may extend liability for violations to agents and other representatives of telecommunications carriers, such as telemarketers.

Our representatives undergo an extensive training program, part of which is designed to educate them about applicable laws and regulations and to try to ensure their compliance with such laws and regulations. Also, we program our call management system to avoid initiating telephone calls during restricted hours or to individuals maintained on our “do not call” list.

### *Canadian Regulation*

In Canada, the Canadian Radio-Television and Telecommunications Commission, referred to as CRTC, enforces rules regarding unsolicited communications using automatic dialing and announcing devices, live voice and fax. Companies that violate any of the restrictions on unsolicited calls may have their telephone service terminated after two business days’ notice from the telephone company. Effective October 1, 2004, the CRTC was to require telemarketers to provide consumers with a unique registration number confirming a consumer’s do not call request; however, on September 28, 2005, the CRTC granted the request of the Canadian Marketing Association, referred to as CMA, for a stay of decision, pending its consideration of the CMA’s appeal.

In November 2005, a bill was announced to amend the Telecommunications Act, which would allow the creation of a Canadian National Do Not Call list where consumers could register once to stop all unwanted telemarketing calls. The CRTC stated that it would be counter-productive to establish a National Do Not Call registry without significant enforcement and administrative measures, which the current bill is lacking. Once revised to include these measures and if passed by Parliament, the CRTC will begin public consultations.

In 2001, the federal government of Canada enacted the Personal Information Protection and Electronic Documents Act, referred to as the Federal Act. Effective January 1, 2004, the Federal Act requires all commercial enterprises to obtain consent for the collection, use, and disclosure of an individual’s personal information. Failure to comply with the Federal Act could result in significant fines and penalties or possible damage awards for the tort of public humiliation. In addition to the foregoing sanctions, the Federal Act also contemplates that any finding of an improper use of personal information will be subject to public disclosure by the Privacy Commissioner. The Federal Act permits any Province of Canada to enact substantially similar legislation governing the subject matter of the Federal Act, in which case the legislation of the Province will override the provisions of the Federal Act. Our Canadian operations are located primarily in the Provinces of Ontario, British Columbia and New Brunswick. British Columbia has enacted legislation, referred to as the B.C. Act, governing the subject matter of the Federal Act. The federal government of Canada has not yet declared the B.C. Act substantially similar to the Federal Act. Until such time as the federal government of Canada makes such declaration, both the B.C. Act and the Federal Act will apply concurrently to our operations in British Columbia. Though neither has yet enacted legislation that is substantially similar to the Federal Act, both Ontario and New Brunswick have indicated that they may enact legislation governing the subject matter of the Federal Act. Failure to comply with the Federal Act, the B.C. Act, as well as, any such future legislation enacted by Ontario, New Brunswick or any other provinces in which we operate, may have an adverse affect on, or limit our current or future, operations.

The Competition Act contains a number of provisions that regulate the conduct of telemarketers in Canada, in particular the manner in which outbound calls are to be conducted. Failure to comply with such legislation could adversely affect our business.

We devote significant and continuous efforts, through training of personnel and monitoring of compliance, to ensure that we comply with all applicable foreign, federal and state regulatory requirements. We believe that we are in material compliance with all such regulatory requirements.

## **Risk Factors**

You should carefully consider the risks described below. If any of the risks actually occur, our business, financial condition or results of future operations could be materially adversely affected. This Annual Report contains forward-looking statements that involve risk and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of many factors, including the risks faced by us described below and elsewhere in this Annual Report.

### **Risks Related to our Business**

#### **Our business is dependent on our ability to grow internally.**

Our business is dependent on our ability to grow internally, which is dependent upon:

- our ability to retain existing clients and expand our existing client relationships; and
- our ability to attract new clients.

Our ability to retain existing clients and expand those relationships is subject to a number of risks, including the risk that:

- we fail to maintain the quality of services we provide to our clients;
- we fail to maintain the level of attention expected by our clients;
- we fail to successfully leverage our existing client relationships to sell additional services; and
- we fail to provide competitively priced services.

Our ability to attract new clients is subject to a number of risks, including:

- the market acceptance of our service offerings;
- the quality and effectiveness of our sales force; and
- the competitive factors within the BPO industry.

If our efforts to retain and expand our client relationships and to attract new clients do not prove effective, it could have a materially adverse effect on our business, results of operations and financial condition.

#### **We compete with a large number of providers in the ARM and CRM industries, and other purchasers of consumer debt. This competition could have a materially adverse effect on our future financial results.**

We compete with a large number of companies in the industries in which we provide services. In the ARM industry, we compete with other sizable corporations in the U.S. and abroad such as GC Services LP, IntelliRisk Management Corporation, and Outsourcing Solutions, Inc., as well as

many regional and local firms. In the CRM industry, we compete with large customer care outsourcing providers such as Convergys Corporation, ICT Group, SITEL Corporation, TeleTech Holdings, Inc., and West Corporation. We may lose business to competitors that offer more diversified services, have greater financial and other resources and/or operate in broader geographic areas than we do. We may also lose business to regional or local firms who are able to use their proximity to or contacts at local clients as a marketing advantage. In addition, many companies perform the BPO services offered by us in-house. Many larger clients retain multiple BPO providers, which exposes us to continuous competition in order to remain a preferred provider. Because of this competition, in the future we may have to reduce our fees to remain competitive and this competition could have a materially adverse effect on our future financial results.

Our Portfolio Management business competes with other purchasers of delinquent consumer accounts receivable, such as Asset Acceptance Capital Corp., Asta Funding, Inc., Encore Capital Group, Inc. and Portfolio Recovery Associates, Inc. The purchased accounts receivable business has become increasingly competitive over the past few years, with several new companies entering the market. While the number of portfolios available for sale has increased, we believe the demand outweighs the supply, which has caused pricing to increase. Our competitors may have greater financial resources or access to credit to purchase portfolios than we do, and may be able to outbid us on available portfolios. In the future we may have to pay more for our portfolios, which could have an adverse impact on our financial results.

**Many of our clients are concentrated in the financial services, telecommunications, and healthcare sectors. If any of these sectors performs poorly or if there are any adverse trends in these sectors it could materially adversely affect us.**

For the year ended December 31, 2006, we derived approximately 34.3 percent of our revenue from clients in the financial services sector, approximately 23.0 percent of our revenue from clients in the telecommunications industry, and approximately 14.6 percent of our revenue from clients in the healthcare sector, in each case excluding purchased accounts receivable. If any of these sectors performs poorly, clients in these sectors may do less business with us, or they may elect to perform the services provided by us in-house. If there are any trends in any of these sectors to reduce or eliminate the use of third-party BPO service providers, it could harm our business and results of operations.

**We have international operations and utilize foreign sources of labor, and various factors relating to our international operations, including fluctuations in currency exchange rates, could adversely affect our results of operations.**

Approximately 6.5% of our 2006 revenues were derived from clients in Canada, the United Kingdom and Australia for ARM and CRM services. Political or economic instability in Canada, the United Kingdom or Australia could have an adverse impact on our results of operations due to diminished revenues in these countries. Our future revenue, costs of operations and profitability could also be affected by a number of other factors related to our international operations, including changes in economic conditions from country to country, changes in a country's political condition, trade protection measures, licensing and other legal requirements, and local tax or foreign exchange issues. Unanticipated currency fluctuations in the Canadian Dollar, British Pound, Euro or the Australian Dollar could lead to lower reported consolidated results of operations due to the translation of these currencies into U.S. dollars when we consolidate our financial results.

We provide ARM and CRM services to our U.S. clients utilizing foreign sources of labor through call centers in Canada, India, the Philippines, Barbados, Antigua, Australia and Panama. Any political or economic instability in these countries could result in our having to replace or reduce these labor sources, which may increase our labor costs and have an adverse impact on our results of operations. A decrease in the value of the U.S. dollar in relation to the currencies of the countries in which we operate could increase our cost of doing business in those countries. In addition, we expect to expand our operations into other countries and, accordingly, will face similar risks with respect to the costs of doing business in such countries including as a result of any decreases in the value of the U.S. dollar in relation to the currencies of such countries. There is no guarantee that we will be able to successfully hedge our foreign currency exposure in the future.

We seek growth opportunities for our business in parts of the world where we have had little or no prior experience. International expansion into new markets with different cultures and laws poses additional risks and costs, including the risk that we will not be able to obtain the required permits, comply with local laws and regulations, hire, train and maintain a workforce, and obtain and maintain physical facilities in a culture and under laws that we are not familiar with. In addition, we may have to customize certain of our collection techniques to work with a different consumer base in a different regulatory environment. Also, we may have to revise certain of our analytical portfolio techniques as we apply them in different countries.

**We are dependent on our employees and a higher turnover rate would have a material adverse effect on us.**

We are dependent on our ability to attract, hire and retain qualified employees. The BPO industry, by its nature, is labor intensive and experiences a high employee turnover rate. Many of our employees receive modest hourly wages and some of these employees are employed on a part-time basis. A higher turnover rate among our employees would increase our recruiting and training costs and could materially adversely impact the quality of services we provide to our clients. If we were unable to recruit and retain a sufficient number of employees, we would be forced to limit our growth or possibly curtail our operations. Growth in our business will require us to recruit and train qualified personnel at an accelerated rate from time to time. We cannot assure you that we will be able to continue to hire, train and retain a sufficient number of qualified employees to meet the needs of our business or to support our growth. If we are unable to do so, our results of operations could be harmed. Any increase in hourly wages, costs of employee benefits or employment taxes could also have a materially adverse affect on our results of operations.

**The employees at one of our offices voted to join a labor union, which could increase our costs and result in a loss of customers.**

In February 2006, the employees at our call center in Surrey, British Columbia, Canada voted in favor of joining the B.C Government and Services Employees' Union. A collective agreement was ratified by the employees in the first quarter of 2007. This action, as well as that of any other employees who are successful in organizing a labor union at any of our locations, could further increase labor costs, decrease operating efficiency and productivity in the future, result in office closures, and result in a loss of customers. Additionally, during May 2006, our Jackson, Michigan facility was the subject of a union campaign from the Teamsters. We are currently not aware of any other union organizing efforts at any of our other facilities.

**If we are not able to respond to technological changes in telecommunications and computer systems in a timely manner, we may not be able to remain competitive.**

Our success depends in large part on our sophisticated telecommunications and computer systems. We use these systems to identify and contact large numbers of debtors and record the results of our collection efforts, as well as to provide customer service to our clients' customers. If we are not able to respond to technological changes in telecommunications and computer systems in a timely manner, we may not be able to remain competitive. We have made a significant investment in technology to remain competitive and we anticipate that it will be necessary to continue to do so in the future. Telecommunications and computer technologies are changing rapidly and are characterized by short product life cycles, so we must anticipate technological developments. If we are not successful in anticipating, managing, or adopting technological changes on a timely basis or if we do not have the capital resources available to invest in new technologies, our business could be materially adversely affected.

**We are highly dependent on our telecommunications and computer systems.**

As noted above, our business is highly dependent on our telecommunications and computer systems. These systems could be interrupted by terrorist acts, natural disasters, power losses, computer viruses, or similar events. Our business is also materially dependent on services provided by various local and long distance telephone companies. If our equipment or systems cease to work or become unavailable, or if there is any significant interruption in telephone services, we may be prevented from providing services and collecting on accounts receivable portfolios we have purchased. Because we generally recognize revenue and generate operating cash flow primarily through ARM collections and providing CRM services, any failure or interruption of services and collections would mean that we would continue to incur payroll and other expenses without any corresponding income.

**An increase in communication rates or a significant interruption in communication service could harm our business.**

Our ability to offer services at competitive rates is highly dependent upon the cost of communication services provided by various local and long distance telephone companies. Any change in the telecommunications market that would affect our ability to obtain favorable rates on communication services could harm our business. Moreover, any significant interruption in communication service or developments that could limit the ability of telephone companies to provide us with increased capacity in the future could harm existing operations and prospects for future growth.

**Implementation of our ERP system could cause business interruptions and negatively affect our profitability and cash flows.**

In 2004, we began planning a multi-year implementation of an ERP system. The first phases of the implementation were rolled out in 2005, and we expect the implementation, as currently planned, will continue in several phases over the next few years. Implementation of ERP systems and the accompanying software carry risks such as cost overruns, project delays, business interruptions, and the diversion of management's attention from operations. These risks could adversely affect us, and could have a material adverse effect on our business, results of operations, financial condition and cash flows.

**We may seek to make strategic acquisitions of companies. Acquisitions involve additional risks that may adversely affect us.**

From time to time, we may seek to make acquisitions of businesses that provide BPO services. We may be unable to make acquisitions if suitable businesses that provide BPO services are not available at favorable prices due to increased competition for these businesses.

We may have to borrow money, incur liabilities, or sell or issue stock to pay for future acquisitions and we may not be able to do so on terms favorable to us, or at all. Additional borrowings and liabilities may have a materially adverse effect on our liquidity and capital resources. If we issue stock for all or a portion of the purchase price for future acquisitions, our stockholders' ownership interest may be diluted. Our common stock is not publicly traded and potential sellers may be unwilling to accept equity in a privately held company as payment for the sale of their business. If potential sellers are not willing to accept our common stock as payment for the sale of their business, we may be required to use more of our cash resources, if available, in order to continue our acquisition strategy.

Completing acquisitions involves a number of risks, including diverting management's attention from our daily operations, other additional management, operational and financial resources and the inability to maintain key pre-acquisition relationships with customers, suppliers and employees. We might not be able to successfully integrate future acquisitions into our business or operate the acquired businesses profitably, and we may be subject to unanticipated problems and liabilities of acquired companies.

**Our success depends on our senior management team and if we are not able to retain them, it could have a materially adverse effect on us.**

We are highly dependent upon the continued services and experience of our senior management team, including Michael J. Barrist, our Chairman, President and Chief Executive Officer. We depend on the services of Mr. Barrist and the other members of our senior management team to, among other things, continue the development and implementation of our growth strategies, and maintain and develop our client relationships.

**Goodwill and other intangible assets represented 61.9 percent of our total assets at December 31, 2006. If the goodwill or the other intangible assets, primarily our customer relationships and trade name, are deemed to be impaired, we may need to take a charge to earnings to write-down the goodwill or other intangibles to its fair value.**

Our balance sheet includes goodwill, which represents the excess of the purchase price over the fair market value of the net assets of acquired businesses based on their respective fair values at the date of acquisition. Trade name represents the fair value of the NCO name and is an indefinite-lived intangible asset. Other intangibles are primarily composed of customer relationships, which represent the information and regular contact we have with our clients, as well as non-compete agreements.

Goodwill is tested at least annually for impairment. The annual impairment test is completed as of October 1<sup>st</sup> of each year. The test for impairment uses a fair value based approach, whereby if the implied fair value of a reporting unit's goodwill is less than its carrying amount, goodwill would be considered impaired. We make significant assumptions to estimate the future revenue and cash flows used to determine the fair value of our reporting units. If the expected revenue and cash flows are not realized or if a sustained significant depression in our market capitalization

indicates that our assumptions are not accurately estimating our fair value, impairment losses may be recorded in the future. The trade name intangible asset will also be reviewed for impairment on an annual basis.

Our other intangibles, consisting of customer relationships and non-compete agreements, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. For example, the loss of a larger client could require a review of the customer relationship for impairment. We made significant assumptions to estimate the future cash flows used to determine the fair value of the customer relationship. If we lost a significant customer relationship, the future cash flows expected to be generated by the customer relationship would be less than the carrying amount, and an impairment loss may be recorded.

As of December 31, 2006, our balance sheet included goodwill, trade name and other intangibles that represented 36.5 percent, 5.9 percent and 19.5 percent of total assets, respectively, and 154.7 percent, 24.9 percent and 82.6 percent of stockholders' equity, respectively. If our goodwill, trade name or customer relationships are deemed to be impaired, we may need to take a charge to earnings to write-down the asset to its fair value.

**Terrorist attacks, war and threats of attacks and war may adversely impact our results of operations, revenue and profitability.**

Terrorist attacks in the United States and abroad, as well as war and threats of war or actual conflicts involving the United States or other countries in which we operate, may adversely impact our operations, including affecting our ability to collect our clients' accounts receivable. More generally, any of these events could cause consumer confidence and spending to decrease. They could also result in an adverse effect on the economies of the United States and other countries in which we operate. Any of these occurrences could have a material adverse effect on our results of operations, collections and revenue.

**Risks Related to our ARM Business**

We are subject to business-related risks specific to the ARM business. Some of those risks are:

**Decreases in our collections due to economic conditions in the United States may have an adverse effect on our results of operations, revenue and profitability.**

Deterioration in economic conditions in the United States may lead to higher rates of unemployment and personal bankruptcy filings and decrease the ability of consumers to pay their debts. Defaulted consumer loans that we service or purchase are generally unsecured, and we may be unable to collect these loans in the case of personal bankruptcy of a consumer. Increases in unemployment rates and bankruptcy filings may result in a decline in our collections, which may adversely impact our results of operations, revenue and profitability.

**Most of our ARM contracts do not require clients to place accounts with us, may be terminated on 30 or 60 days notice, and are on a contingent fee basis. We cannot guarantee that existing clients will continue to use our services at historical levels, if at all.**

Under the terms of most of our ARM contracts, clients are not required to give accounts to us for collection and usually have the right to terminate our services on 30 or 60 days notice. Accordingly, we cannot guarantee that existing clients will continue to use our services at historical levels, if at all. In addition, most of these contracts provide that we are entitled to be paid

only when we collect accounts. Therefore, for these contracts, we can only recognize revenues upon the collection of funds on behalf of clients.

**If we fail to comply with government regulation of the collections industry, it could result in the suspension or termination of our ability to conduct business.**

The collections industry is regulated under various U.S. federal and state, Canadian and United Kingdom laws and regulations. Many states, as well as Canada and the United Kingdom, require that we be licensed as a debt collection company. The Federal Trade Commission, referred to as the FTC, has the authority to investigate consumer complaints against debt collection companies and to recommend enforcement actions and seek monetary penalties. If we fail to comply with applicable laws and regulations, it could result in fines as well as the suspension or termination of our ability to conduct collections, which would materially adversely affect us. State regulatory authorities have similar powers. For example, the New York and Massachusetts Attorneys General are currently conducting inquiries or investigations regarding our debt collection practices in such states. If such matters resulted in further investigations and subsequent enforcement actions, we could be subject to fines as well as the suspension or termination of our ability to conduct collections, which would materially adversely affect our financial position and results of operations. In addition, new federal, state or foreign laws or regulations, or changes in the ways these rules or laws are interpreted or enforced, could limit our activities in the future or significantly increase the cost of regulatory compliance. If we expand our international operations, we may become subject to additional government controls and regulations in other countries, which may be stricter or more burdensome than those in the United States.

Several of the industries we serve are also subject to varying degrees of government regulation. Although our clients are generally responsible for complying with these regulations, we could be subject to various enforcement or private actions for our failure, or the failure of our clients, to comply with these regulations.

**Risks Related to our CRM Business**

We are subject to business-related risks specific to the CRM business. Some of those risks are:

**Consumer resistance to outbound services could harm the CRM services industry.**

As the CRM services industry continues to grow, the effectiveness of CRM services as a direct marketing tool may decrease as a result of consumer saturation and increased consumer resistance to customer acquisition activities, particularly direct sales and telemarketing. This could result in a decrease in the demand for our CRM services.

**The CRM division relies on a few key clients for a significant portion of its revenues. The loss of any of these clients or their failure to pay us could reduce revenues and adversely affect results of operations.**

The CRM division is characterized by substantial revenues from a few key clients. While no individual CRM client represented more than 10 percent of our consolidated revenue, we are exposed to customer concentration within this division. Most of these clients are not contractually obligated to continue to use our services at historic levels or at all. If any of these clients were to significantly reduce the amount of service, fail to pay, or terminate the relationship altogether, our CRM business could be harmed.

**A decrease in demand for CRM services in one or more of the industries to which we provide services could reduce revenues and adversely affect results of operations.**

Our CRM business is concentrated in the telecommunications industry. During 2004, announcements were made by a number of telecommunications companies that they were significantly reducing their participation in consumer markets. As a result, there have been reductions of services performed for certain of our telecommunications clients. A further reduction of such services or the elimination of the use of outsourced CRM services in this or any other industry could harm our CRM business.

**Government regulation of the CRM industry and the industries we serve may increase our costs and restrict the operation and growth of our CRM business.**

The CRM services industry is subject to an increasing amount of regulation in the United States and Canada. In the United States, the FCC places restrictions on unsolicited automated telephone calls to residential telephone subscribers by means of automatic telephone dialing systems, prerecorded or artificial voice messages and telephone fax machines, and requires CRM firms to develop a “do not call” list and to train their CRM personnel to comply with these restrictions. The FTC regulates both general sales practices and telemarketing specifically and has broad authority to prohibit a variety of advertising or marketing practices that may constitute “unfair or deceptive acts or practices.” Most of the statutes and regulations in the United States allow a private right of action for the recovery of damages or provide for enforcement by the FTC, state attorneys general or state agencies permitting the recovery of significant civil or criminal penalties, costs and attorneys’ fees in the event that regulations are violated. The Canadian Radio-Television and Telecommunications Commission enforces rules regarding unsolicited communications using automatic dialing and announcing devices, live voice and fax. We cannot assure you that we will be in compliance with all applicable regulations at all times. We also cannot assure you that new laws, if enacted, will not adversely affect or limit our current or future operations.

Several of the industries we serve, particularly the insurance, financial services and telecommunications industries, are subject to government regulation. We could be subject to a variety of private actions or regulatory enforcement for our failure or the failure of our clients to comply with these regulations. Our results of operations could be adversely impacted if the effect of government regulation of the industries we serve is to reduce the demand for our CRM services or expose us to potential liability. We, and our employees who sell insurance products, are required to be licensed by various state insurance commissions for the particular type of insurance product sold and to participate in regular continuing education programs. Our participation in these insurance programs requires us to comply with certain state regulations, changes in which could materially increase our operating costs associated with complying with these regulations.

**Risks Related to our Purchased Accounts Receivable Business**

We are subject to business-related risks specific to the Purchased Accounts Receivable business. Some of those risks are:

**Collections may not be sufficient to recover the cost of investments in purchased accounts receivable and support operations.**

We purchase past due accounts receivable generated primarily by consumer credit transactions. These are obligations that the individual consumer has failed to pay when due. The

accounts receivable are purchased from consumer creditors such as banks, finance companies, retail merchants, hospitals, utilities, and other consumer-oriented companies. Substantially all of the accounts receivable consist of account balances that the credit grantor has made numerous attempts to collect, has subsequently deemed uncollectible, and charged off. After purchase, collections on accounts receivable could be reduced by consumer bankruptcy filings. The accounts receivable are purchased at a significant discount, typically less than 10 percent of face value, and, although we estimate that the recoveries on the accounts receivable will be in excess of the amount paid for the accounts receivable, actual recoveries on the accounts receivable will vary and may be less than the amount expected, and may even be less than the purchase price paid for such accounts. In addition, the timing or amounts to be collected on those accounts receivable cannot be assured. If cash flows from operations are less than anticipated as a result of our inability to collect accounts receivable, we may have difficulty servicing our debt obligations and may not be able to purchase new accounts receivable, and our future growth and profitability will be materially adversely affected. There can be no assurance that our operating performance will be sufficient to service our debt or finance the purchase of new accounts receivable.

**We use estimates to report results. If collections on portfolios are materially less than expected, we may be required to record impairment expenses that could have a materially adverse effect on us.**

Our revenue is recognized based on estimates of future collections on portfolios of accounts receivable purchased. Although these estimates are based on analytics, the actual amount collected on portfolios and the timing of those collections will differ from our estimates. If collections on portfolios are materially less than estimated, we may be required to record impairment expenses that could materially adversely affect our earnings, financial condition and creditworthiness.

**We may be adversely affected by possible shortages of available accounts receivable for purchase at favorable prices.**

The availability of portfolios of past due consumer accounts receivable for purchase at favorable prices depends on a number of factors outside of our control, including the continuation of the current growth trend in consumer debt and competitive factors affecting potential purchasers and sellers of portfolios of accounts receivable. The growth in consumer debt may also be affected by changes in credit grantors' underwriting criteria and regulations governing consumer lending. Any slowing of the consumer debt growth trend could result in less credit being extended by credit grantors. Consequently, fewer delinquent accounts receivable could be available at prices that we find attractive. If competitors raise the prices they are willing to pay for portfolios of accounts receivable above those we wish to pay, we may be unable to buy the type and quantity of past due accounts receivable at prices consistent with our historic return targets. In addition, we may overpay for portfolios of delinquent accounts receivable, which may have a materially adverse effect on our results of operations.

**We may be unable to compete with other purchasers of past due accounts receivable, which may have an adverse effect on our combined financial results.**

We face bidding competition in our acquisitions of portfolios of past due consumer accounts receivable. Some of our existing competitors and potential new competitors may have greater financial and other resources that allow them to offer higher prices for the accounts receivable portfolios. New purchasers of such portfolios entering the market also cause upward price pressures. We may not have the resources or ability to compete successfully with our existing and potential new competitors. To remain competitive, we may have to increase our bidding prices,

which may have an adverse impact on our financial results.

## **Risks Related to our Indebtedness**

### **Our substantial leverage and significant debt service obligations could adversely affect our financial condition and our ability to fulfill our obligations and operate our business.**

As a result of the acquisition of our company by an entity controlled by One Equity Partners and its affiliates with participation by Michael J. Barrist, Chairman, President and Chief Executive Officer of the Company, certain other members of executive management and other co-investors, we are highly leveraged and have significant debt service obligations. Our financial performance could be affected by our substantial leverage. At December 31, 2006, our total indebtedness was \$918.3 million, and we had \$59.2 million of borrowing capacity under the revolving portion of our new senior secured credit facilities and \$4.8 million of letters of credit outstanding. We may also incur additional indebtedness in the future.

This high level of indebtedness could have important consequences, including:

- we may have difficulty obtaining financing in the future for working capital, capital expenditures, acquisitions or other purposes;
- we will need to use all, or a substantial portion, of our available cash flow to pay interest and principal on our debt, which will reduce the amount of money available to finance our operations and other business activities;
- some of our debt, including our borrowings under our senior credit facilities, has variable rates of interest, which exposes us to the risk of increased interest rates;
- our debt level increases our vulnerability to general economic downturns and adverse industry conditions;
- our debt level could limit our flexibility in planning for, or reacting to, changes in our business and in our industry in general;
- our substantial amount of debt and the amount we must pay to service our debt obligations could place us at a competitive disadvantage compared to our competitors that have less debt;
- our customers may react adversely to our significant debt level and seek or develop alternative suppliers; and
- our failure to comply with the financial and other restrictive covenants in our debt instruments which, among other things, require us to maintain specified financial ratios and limit our ability to incur debt and sell assets, could result in an event of default that, if not cured or waived, could have a material adverse effect on our business or prospects.

Our high level of indebtedness requires that we use a substantial portion of our cash flow from operations to pay principal of, and interest on, our indebtedness, which will reduce the availability of cash to fund working capital requirements, capital expenditures, research and development or other general corporate or business activities, including future acquisitions.

In addition, a substantial portion of our indebtedness bears interest at variable rates, including indebtedness under our floating rate senior notes and our senior credit facility. If market interest rates increase, debt service on our variable-rate debt will rise, which would adversely affect our cash flow. Although our senior credit facility require us to employ hedging strategies such that not less than 50 percent of the aggregate principal amount of the term loan carries a fixed rate of interest for a period of three years following consummation of the Transaction, any hedging arrangement in place may not offer complete protection from this risk. Additionally, the revolving

portion of the senior credit facility may not be hedged and, accordingly, the portion that is not hedged will be subject to changes in interest rates.

**We may be unable to generate sufficient cash to service all of our indebtedness and meet our other ongoing liquidity needs and may be forced to take other actions to satisfy our obligations under our indebtedness, which may be unsuccessful.**

Our ability to make scheduled payments or to refinance our debt obligations, and to fund our planned capital expenditures and other ongoing liquidity needs, depends on our financial and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We cannot assure you that our business will generate sufficient cash flow from operations or that future borrowings will be available to us under our senior credit facility or otherwise in an amount sufficient to permit us to pay the principal, premium, if any, and interest on our indebtedness or to fund our other liquidity needs. We may need to refinance all or a portion of our debt on or before maturity. We may be unable to refinance any of our debt on commercially reasonable terms.

If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay capital expenditures, seek additional capital or seek to restructure or refinance our indebtedness. These alternative measures may be unsuccessful and may not permit us to meet our scheduled debt service obligations. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to sell material assets or operations to attempt to meet our debt service and other obligations. The senior credit facility and the indentures under which the notes were issued restrict our ability to use the proceeds from certain asset sales. We may be unable to consummate those asset sales to raise capital or sell assets at prices that we believe are fair and proceeds that we do receive may be inadequate to meet any debt service obligations then due.

### **Risks Related to our Structure**

**We are controlled by an investor group led by One Equity Partners, a private equity firm, and its affiliates, whose interests may not be aligned with those of our noteholders.**

Our equity investors control the election of our directors and thereby have the power to control our affairs and policies, including the appointment of management, the issuance of additional stock, stock repurchase programs and the declaration and payment of dividends. In addition, our equity investors must consent to the entering into of mergers, sales of substantially all our assets and certain other transactions.

Circumstances may occur in which the interests of our equity investors could be in conflict with those of our noteholders. For example if we encounter financial difficulties or are unable to pay our debts as they mature, our equity investors might pursue strategies that favor equity investors over our debt investors. One Equity Partners may also have an interest in pursuing acquisitions, divestitures, financing or other transactions that, in their judgment, could enhance their equity investments, even though such transaction might involve risk to our noteholders. Additionally, One Equity Partners is not prohibited from making investments in any of our competitors.

## **Properties**

We currently operate 63 offices in the United States, including our corporate headquarters, of which 57 are used for ARM operations and six are used for CRM operations. We also operate 15 offices in Canada, eight for ARM operations and seven for CRM operations, 15 offices in Australia for ARM operations, two offices in the United Kingdom for ARM operations, two offices in Puerto Rico for ARM operations, four offices in Panama for CRM operations, one office in Barbados for both ARM and CRM operations, and one office in the Philippines for ARM and CRM operations. The leases of these facilities expire between 2007 and 2016, and most contain renewal options.

We believe that our facilities are adequate for our current operations, but additional facilities may be required to support growth. We believe that suitable additional or alternative space will be available as needed on commercially reasonable terms.

## **Legal Proceedings**

### *Fort Washington Flood:*

In June 2001, the first floor of our Fort Washington, Pennsylvania, headquarters was severely damaged by a flood caused by remnants of Tropical Storm Allison. We subsequently decided to relocate our corporate headquarters to Horsham, Pennsylvania. We filed a lawsuit in the Court of Common Pleas, Montgomery County, Pennsylvania (Civil Action No. 01-15576) against the current landlord and the former landlord of the Fort Washington facilities to terminate the leases and to obtain other relief. The landlord and former landlord have filed counter-claims against us. We maintain a reserve that we believe is adequate to address our exposure to this matter and we plan to continue to contest this matter.

### *U.S. Department of Justice:*

On February 24, 2006, the U.S. Department of Justice alleged certain civil damages of approximately \$5.0 million. The alleged damages relate to a matter we reported to federal authorities and the client in 2003 involving three employees who engaged in unauthorized student loan consolidations in connection with a client contract. The responsible employees were terminated at that time in 2003. We do not agree with the allegations regarding damages and have and will continue to engage in discussions with the Department of Justice in an effort to amicably resolve the matter. We have been advised and expect that actual damages incurred as a result of this incident, if any, will be covered by insurance.

### *Tax Matters:*

In 2004, we received notice of a proposed reassessment from a foreign taxing authority relating to certain matters occurring from 1998 through 2001 regarding one of our subsidiaries. In September 2006, we received the formal notice of reassessment in the amount of \$14.6 million including interest and penalties (converted as of December 31, 2006), and in December 2006 we paid a deposit of \$8.5 million including interest. We maintain a reserve that we believe is adequate to address our exposure to this matter and have contested the reassessment.

*New York and Massachusetts Attorneys General:*

In August 2006, we received a subpoena from the New York Attorney General and in September 2006 we received a letter from the Massachusetts Attorney General requesting information relating to our Company's debt collection practices in such states. We are in the process of responding to such inquiries or investigations and providing certain information to the Attorneys General offices in connection with the letters. We believe we are in compliance with the state laws of New York and Massachusetts relating to debt collection practices in all material respects. However no assurance can be given that any such inquiries or investigations will not result in a formal investigation or an enforcement action. Any such enforcement actions could result in fines as well as the suspension or termination of our ability to conduct business in such states.

*Other:*

We are involved in other legal proceedings, regulatory investigations and tax examinations from time to time in the ordinary course of business. Management believes that none of these other legal proceedings, regulatory investigations, or tax examinations will have a materially adverse effect on our financial condition or results of operations.

## Executive Officers and Directors

| <u>Name</u>                | <u>Age</u> | <u>Position</u>  |
|----------------------------|------------|--|
| Michael J. Barrist.....    | 46         | Chairman of the Board, President and Chief Executive Officer                   |
| Stephen W. Elliott .....   | 44         | Executive Vice President, Information Technology and Chief Information Officer |
| Joshua Gindin, Esq. ....   | 50         | Executive Vice President and General Counsel                                   |
| Steven Leckerman .....     | 54         | Executive Vice President and Chief Operating Officer – Global Services         |
| John R. Schwab .....       | 39         | Executive Vice President, Finance, Chief Financial Officer and Treasurer       |
| Steven L. Winokur.....     | 46         | Executive Vice President, Development and Chief Administrative Officer         |
| Albert Zezulinski.....     | 60         | Executive Vice President, Global Portfolio Operations                          |
| Austin A. Adams .....      | 63         | Director   |
| Edward A. Kangas.....      | 62         | Director   |
| Leo J. Pound .....         | 52         | Director   |
| James S. Rubin .....       | 38         | Director   |
| Daniel J. Selmonosky ..... | 41         | Director   |
| Tarek N. Shoeb.....        | 37         | Director   |

*Michael J. Barrist* – Mr. Barrist has served as our Chairman of the Board, President and Chief Executive Officer since purchasing the Company in 1986. Mr. Barrist was employed by U.S. Healthcare, Inc., a managed healthcare company, from 1984 to 1986, most recently as Vice President of Operations, and was employed by Gross & Company, a certified public accounting firm, from 1980 through 1984. Mr. Barrist is a Certified Public Accountant.

*Stephen W. Elliott* – Mr. Elliott joined us in 1996 as Senior Vice President, Technology and Chief Information Officer after having provided consulting services to us for the year prior to his arrival. Mr. Elliott became an Executive Vice President in February 1999. Prior to joining us, Mr. Elliott was employed by Electronic Data Systems, a computer services company, for almost 10 years, most recently as Senior Account Manager.

*Joshua Gindin, Esq.* – Mr. Gindin joined us in May 1998. Prior to joining us, Mr. Gindin was a partner in the law firm of Kessler & Gindin, which had served as our legal counsel since 1986.

*Steven Leckerman* – Mr. Leckerman joined us in 1995 as Senior Vice President, Collection Operations, became Executive Vice President, U.S. Operations in January 2001, and in August 2003 became Executive Vice President and Chief Operating Officer – Accounts Receivable Management, North America. In November 2006, Mr. Leckerman became Chief Operating Officer of Global Services. From 1982 to 1995, Mr. Leckerman was employed by Allied Bond Corporation, a collection company that was a division of TransUnion Corporation, where he served as manager of dialer and special projects.

*John R. Schwab* – Mr. Schwab joined us as Senior Vice President, Finance and Chief Accounting Officer, through the acquisition of RMH Teleservices, Inc. in April 2004, where he was the Chief Financial Officer since 2003. In May 2006, Mr. Schwab became Executive Vice President, Finance, Chief Financial Officer and Treasurer. From 2000 to 2003, Mr. Schwab was employed by Inrange Technologies, Inc., a data storage networking company, most recently as the Chief Financial Officer. Prior to that, Mr. Schwab worked for Arthur Andersen for 11 years, most recently as Senior Manager in the Growth Company Practice. Mr. Schwab is a Certified Public Accountant.

*Steven L. Winokur* – Mr. Winokur joined us in December 1995 as Executive Vice President, Finance and Chief Financial Officer, and also became Chief Operating Officer - Shared Services in August 2003. In May 2006, Mr. Winokur became Executive Vice President, Development and Chief Administrative Officer. Prior to that, Mr. Winokur acted as a part-time consultant to us since 1986. From February 1992 to December 1995, Mr. Winokur was the principal of Winokur & Associates, a certified public accounting firm. From March 1981 to February 1992, Mr. Winokur was with Gross & Company, a certified public accounting firm, where he most recently served as Administrative Partner. Mr. Winokur is a Certified Public Accountant.

*Albert Zezulinski* – Mr. Zezulinski joined us in January 2001 as Executive Vice President, Health Services, became Executive Vice President, Corporate and Government Affairs in May 2002, and in September 2005 became Executive Vice President, Global Portfolio Operations. Mr. Zezulinski has more than 30 years of consulting and healthcare experience. Prior to joining us, Mr. Zezulinski was the Director of Healthcare Financial Services for BDO Seidman, LLP, an international accounting and consulting firm.

*Austin A. Adams* – Mr. Adams was the Corporate Chief Information Officer of JPMorgan Chase from July 2004, when JPMorgan Chase merged with Bank One Corporation, until his retirement in October 2006. Prior to the merger, Mr. Adams was Executive Vice President and Chief Information Officer of Bank One. Prior to joining Bank One in 2001, Mr. Adams was Chief Information Officer of First Union Corporation, now known as Wachovia Corp. Mr. Adams was appointed to the Board of Directors in February 2007.

*Edward A. Kangas* – Mr. Kangas was Chairman and Chief Executive Officer of Deloitte Touche Tohmatsu from 1989 until his retirement in 2000. Mr. Kangas served as Managing Partner of Deloitte & Touche (USA) from 1989 to 1994 and Managing Partner and Chief Executive Officer of Touche Ross in from 1985 to 1989. After his retirement, Mr. Kangas served as a consultant to Deloitte until 2004. Mr. Kangas was appointed to the Board of Directors in February 2007.

*Leo J. Pound* – Mr. Pound has been a Principal of Pound Consulting, which provides management consultant services to both public and private enterprises, since July 2000. From February 1999 to July 2000, Mr. Pound was Chief Financial Officer of Marble Crafters, a stone importer and fabricator. From October 1995 to February 1999, he was Chief Financial Officer of Jos. H. Stomel & Sons, a wholesale distributor. Mr. Pound is a Certified Public Accountant and a member of the American and Pennsylvania Institutes of Certified Public Accountants. Mr. Pound was appointed to the Board of Directors in February 2007. He had previously served on the Board of Directors of NCO Group, Inc. from 2000 until the date of the Transaction in November 2006.

*James S. Rubin* – Mr. Rubin is a Partner at One Equity Partners. Prior to joining One Equity Partners in 2001, Mr. Rubin was a Vice President with Allen & Company, Incorporated, a New York investment bank specializing in media and entertainment transactions and advisory work (“Allen & Company”). From 1996 to 1998, he held a number of senior positions with the Federal Communications Commission, including Executive Director of the Education Technology Task Force and General Counsel to the Chief of the Wireless Bureau. Mr. Rubin was appointed to the Board of Directors in 2006 in connection with the Transaction.

*Daniel J. Selmonosky* – Mr. Selmonosky is a Partner at One Equity Partners. Prior to joining One Equity Partners in 2001, Mr. Selmonosky was a Vice President and Director with Allen & Company. From 1988 to 1991, he worked at Goldman Sachs & Co. in the mergers and acquisitions and the principal investment groups. Mr. Selmonosky was appointed to the Board of Directors in 2006 in connection with the Transaction.

*Tarek N. Shoeb* – Mr. Shoeb is a Partner at One Equity Partners. Mr. Shoeb joined One Equity Partners in 2002 as a Vice President. Prior to joining One Equity Partners, Mr. Shoeb was a Senior Associate at Doughty Hanson & Co., a leveraged-buyout firm from 2001 to 2002. From 2000 to 2001, Mr. Shoeb worked at Illigent.com, where he served as Chief Executive Officer, and from 1997 to 2000 he worked as an Associate at Goldman Sachs & Co. Mr. Shoeb was appointed to the Board of Directors in 2006 in connection with the Transaction.

## Selected Financial Data

### SELECTED FINANCIAL DATA <sup>(1)</sup> (Amounts in thousands)

|   | Combined <sup>(2) (3)</sup> | Successor <sup>(4)</sup><br>Period from<br>July 13, 2006<br>(date of inception)<br>through<br>December 31,<br>2006 | Predecessor <sup>(5)</sup><br>Period from<br>January 1<br>through<br>November 15,<br>2006 | Predecessor <sup>(5)</sup>       |                  |                  |                  |
|---|-----------------------------|--|---|----------------------------------|------------------|------------------|------------------|
|   |                             |  |   | For the years ended December 31, |                  |                  |                  |
|   |                             |  |   | 2005                             | 2004             | 2003             | 2002             |
| <b>Statement of Operations Data:</b>                |                             |  |   |                                  |                  |                  |                  |
| Revenues:   |                             |  |   |                                  |                  |                  |                  |
| Services  | \$ 1,002,077                | \$ 126,739   | \$ 875,338  | \$ 906,258                       | \$ 840,346       | \$ 676,793       | \$ 637,288       |
| Portfolio   | 165,263                     | 13,557   | 151,706   | 133,868                          | 99,451           | 77,023           | 66,162           |
| Portfolio sales                                     | 22,757                      | -  | 22,757  | 12,157                           | -                | -                | -                |
| Total revenues                                      | <u>1,190,097</u>            | <u>140,296</u>   | <u>1,049,801</u>  | <u>1,052,283</u>                 | <u>939,797</u>   | <u>753,816</u>   | <u>703,450</u>   |
| Operating costs and expenses:                       |                             |  |   |                                  |                  |                  |                  |
| Payroll and related expenses                        | 630,494                     | 76,611   | 553,883   | 528,932                          | 472,915          | 350,369          | 335,405          |
| Selling, general and administrative expenses        | 422,927                     | 47,777   | 375,150   | 376,606                          | 324,187          | 282,268          | 249,672          |
| Restructuring charges                               | 12,765                      | -  | 12,765  | 9,621                            | -                | -                | -                |
| Depreciation and amortization expense               | 58,243                      | 11,548   | 46,695  | 45,787                           | 40,225           | 31,628           | 27,324           |
| Income from operations                              | <u>65,668</u>               | <u>4,360</u>   | <u>61,308</u>   | <u>91,337</u>                    | <u>102,470</u>   | <u>89,551</u>    | <u>91,049</u>    |
| Other expense                                       | 36,187                      | 14,545   | 21,642  | 19,423                           | 17,612           | 17,943           | 17,970           |
| Income (loss) before provision for income taxes     | 29,481                      | (10,185)   | 39,666  | 71,914                           | 84,858           | 71,608           | 73,079           |
| Income tax expense (benefit)                        | 10,965                      | (3,777)  | 14,742  | 26,182                           | 32,389           | 26,732           | 27,702           |
| Income (loss) before minority interest              | 18,516                      | (6,408)  | 24,924  | 45,732                           | 52,469           | 44,876           | 45,377           |
| Minority interest                                   | (4,047)                     | (157)  | (3,890)   | (1,213)                          | (606)            | (2,430)          | (3,218)          |
| Net income (loss)                                   | <u>\$ 14,469</u>            | <u>\$ (6,565)</u>  | <u>\$ 21,034</u>  | <u>\$ 44,519</u>                 | <u>\$ 51,863</u> | <u>\$ 42,446</u> | <u>\$ 42,159</u> |
| <b>Statement of Cash Flows Data:</b>                |                             |  |   |                                  |                  |                  |                  |
| Net cash provided by (used in) operating activities | \$ 100,374                  | \$ (9,298)   | \$ 109,672  | \$ 89,550                        | \$ 99,019        | \$ 101,056       | \$ 64,005        |
| Net cash (used in) provided by investing activities | (1,001,759)                 | (988,216)  | (13,543)  | (189,486)                        | (1,458)          | 9,996            | (39,490)         |
| Net cash provided by (used in) financing activities | 910,639                     | 1,008,919  | (98,280)  | 97,639                           | (119,542)        | (92,245)         | (31,861)         |
|   |                             |  | <b>Successor</b>  | <b>Predecessor</b>               |                  |                  |                  |
|   |                             |  | <b>December 31,</b>   | <b>December 31,</b>              |                  |                  |                  |
|   |                             |  | <b>2006</b>   | <b>2005</b>                      | <b>2004</b>      | <b>2003</b>      | <b>2002</b>      |
| <b>Balance Sheet Data:</b>                          |                             |  |   |                                  |                  |                  |                  |
| Cash and cash equivalents                           |                             |  | \$ 13,899   | \$ 23,716                        | \$ 26,334        | \$ 45,644        | \$ 25,159        |
| Working capital                                     |                             |  | 181,287   | 171,587                          | 73,547           | 106,409          | 107,731          |
| Total assets  |                             |  | 1,644,139   | 1,327,962                        | 1,113,889        | 946,111          | 966,281          |
| Long-term debt, net of current portion              |                             |  | 881,621   | 321,834                          | 186,339          | 248,964          | 334,423          |
| Minority interest                                   |                             |  | 55,628  | 34,643                           | -                | 26,848           | 24,427           |
| Stockholders' equity                                |                             |  | 388,321   | 743,114                          | 695,601          | 490,417          | 435,762          |

<sup>(1)</sup> This data should be read in conjunction with the consolidated financial statements, including the accompanying notes, included elsewhere in this Annual Report.

<sup>(2)</sup> The combined results for the year ended December 31, 2006 represent the addition of the Predecessor period from January 1, 2006 through November 15, 2006 and the Successor period from July 13, 2006 through December 31, 2006. Collect Holdings was formed on July 13, 2006 (there were no operations from the date of inception until the Transaction on November 15, 2006). This combination does not comply with GAAP or with the rules of pro forma presentation, however we believe it provides the most meaningful comparison of our results.

<sup>(3)</sup> Includes \$33.9 million, net of taxes, of charges and costs related to the Transaction and the Company's restructuring and integration plans.

<sup>(4)</sup> Includes \$22.8 million, net of taxes, of charges and costs related to the Transaction.

<sup>(5)</sup> Includes \$11.1 million, net of taxes, of charges and costs related to the Transaction and the Company's restructuring and integration plans.

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Overview**

On November 15, 2006, NCO Group, Inc. was acquired by and became a wholly owned subsidiary of Collect Holdings Inc., an entity controlled by One Equity Partners and its affiliates, a private equity investment fund, with participation by Michael J. Barrist, Chairman, President and Chief Executive Officer of NCO Group, Inc., certain other members of executive management and other co-investors, referred to as the Transaction. Under the terms of the merger agreement, NCO Group, Inc. shareholders received \$27.50 in cash, without interest, for each share of NCO Group, Inc. common stock that they held. The accompanying consolidated financial statements are those of Collect Holdings, Inc., which is referred to as NCO Group, Inc. due to the subsequent merger of NCO Group, Inc. with and into Collect Holdings, Inc. and the name change to NCO Group, Inc. The accompanying consolidated financial statements are presented for two periods, Predecessor and Successor which relate to the period of operations preceding the Transaction and the period of operations succeeding the Transaction, respectively. Collect Holdings was formed on July 13, 2006 (there were no operations from the date of inception until the Transaction on November 15, 2006). We have prepared our discussion of the results of operations by comparing the mathematical combination, without making any pro forma adjustments, of the Successor and Predecessor periods in the year ended December 31, 2006 to the year ended December 31, 2005. This presentation does not comply with generally accepted accounting principles (GAAP); however, we believe it provides the most meaningful comparison of our results. The combined operating results have not been prepared as pro forma results under applicable regulations and may not reflect the actual results we would have achieved if the Transaction did not occur and may not be predictive of future results of operations.

We are a holding company and conduct substantially all of our business operations through our subsidiaries. We are an international provider of business process outsourcing services, referred to as BPO, primarily focused on accounts receivable management, referred to as ARM, and customer relationship management, referred to as CRM, serving a wide range of clients in North America and abroad through our global network of over 100 offices. We also purchase and manage past due consumer accounts receivable from consumer creditors such as banks, finance companies, retail merchants, utilities, healthcare companies and other consumer-oriented companies.

During 2006, we generated approximately 59 percent of our ARM revenue from the recovery of delinquent accounts receivable on a contingency fee basis. Our ARM contingency fees range from six percent for the management of accounts placed early in the accounts receivable cycle to 50 percent for accounts that have been serviced extensively by the client or by third-party providers. Our average fee for ARM contingency-based revenue across all industries was approximately 17 percent during 2006, 18 percent during 2005 and 19 percent during 2004. In addition, we generate revenue from fixed fee services for certain ARM services. Generally, revenue is earned and recognized upon collection of accounts receivable for contingency fee services and as work is performed for fixed fee services. We enter into contracts with most of our clients that define, among other things, fee arrangements, scope of services, and termination provisions. Clients typically have the right to terminate their contracts on 30 or 60 days' notice. Approximately 41 percent of our ARM revenue is generated from contractual collection services, where fees are based on a monthly rate or a per service charge, and other ARM services.

During 2006, approximately 78 percent of our CRM revenue was generated from inbound services, which consist primarily of customer service and technical support programs, and to a lesser extent acquisition and retention services. Inbound services involve the processing of

incoming calls, often placed by our clients' customers using toll-free numbers, to a customer service representative for service, order fulfillment or information. During 2006, outbound services, which consist of customer acquisition and customer retention services, represented approximately 22 percent of our CRM revenue.

Our operating costs consist principally of payroll and related costs; selling, general and administrative costs; and depreciation and amortization. Payroll and related expenses consist of wages and salaries, commissions, bonuses, and benefits for all of our employees, including management and administrative personnel. Selling, general and administrative expenses include telephone, postage and mailing costs, outside collection attorneys and other third-party collection services providers, and other collection costs, as well as expenses that directly support operations, including facility costs, equipment maintenance, sales and marketing, data processing, professional fees, and other management costs. During 2005 and the first six months of 2006, the earnings of the CRM division were impacted by increased expenses associated with implementing new clients. We incur the upfront expenses required to begin working for a new client, such as facilities and telephone expense, before we begin generating the offsetting revenue.

We have grown rapidly, through both acquisitions as well as internal growth. During 2006, we completed two acquisitions: Australian Receivables Limited, referred to as ARL, in July 2006 for \$3.3 million; and Star Contact (BVI) Ltd and Call Center Telemarketing Pro-Panama, S.A., referred to as Star Contact, in December 2006 for \$36.0 million. During 2005, we completed three acquisitions: Creative Marketing Strategies, referred to as CMS, in May 2005 for \$5.9 million; seven wholly owned subsidiaries of Marlin Integrated Capital Holding Corporation, referred to as Marlin, in September 2005 for \$89.9 million; and substantially all of the operating assets, including purchased portfolio assets, of Risk Management Alternatives Parent Corp. and its subsidiaries, referred to as RMA, in September 2005 for \$116.1 million.

On November 15, 2006, we reorganized our business segments in connection with a management realignment. The ARM North America and ARM International segments have been combined and renamed ARM. The information presented below has been restated to reflect this reorganization.

Our business currently consists of three operating divisions: ARM, CRM and Portfolio Management.

## **Critical Accounting Policies and Estimates**

### *General*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates. We believe the following accounting policies and estimates are the most critical and could have the most impact on our results of operations. For a discussion of these and other accounting policies, see note 2 in our Notes to Consolidated Financial Statements.

As a result of the Transaction, the majority of our assets and liabilities, including our portfolio of accounts receivable, have been adjusted to their fair market value as of the date of the Transaction, in accordance with SFAS No. 141, "Business Combinations." We made significant assumptions in determining the fair market value of intangible assets and other assets and

liabilities in connection with purchase accounting. Such adjustments to fair market value and the allocation of purchase price between identifiable intangibles and goodwill (as discussed below) will have an impact on our revenues and profitability. Additionally, in accordance with Emerging Issues Task Force Issue No. 88-16, "Basis in Leveraged Transactions," a portion of the equity related to our management stockholders was recorded at the stockholder's predecessor basis and a corresponding portion of the acquired assets was reduced accordingly.

#### *Goodwill, Other Intangible Assets and Purchase Accounting*

Purchase accounting requires that assets acquired and liabilities assumed be recorded at their fair market value at the date of acquisition. Our balance sheet includes amounts designated as "Goodwill", "Trade name" and "Customer relationships and other intangible assets". Goodwill represents the excess of the purchase price over the fair market value of the net assets of acquired businesses. Trade name represents the fair value of the NCO name. Other intangible assets consist primarily of customer relationships, which represent the information and regular contact we have with our clients, and non-compete agreements.

As of December 31, 2006, our balance sheet included goodwill, trade name and other intangibles that represented 36.5 percent, 5.9 percent and 19.5 percent of total assets, respectively, and 154.7 percent, 24.9 percent and 82.6 percent of stockholders' equity, respectively.

Goodwill is tested for impairment at least annually and as triggering events occur. The annual impairment test is completed as of October 1st of each year. The test for impairment is performed at the reporting unit level and involves a two-step approach, the first step identifies any potential impairment and the second step measures the amount of the impairment, if applicable. The first test for potential impairment uses a fair value based approach, whereby the implied fair value of a reporting unit's goodwill is compared to its carrying amount, if the fair value is less than the carrying amount, the reporting unit's goodwill would be considered impaired and we would be required to take a charge to earnings, which could be material. Since the Transaction occurred on November 15, 2006, we used the valuations performed in connection with the Transaction to identify any potential impairment for 2006. We did not record any impairment charges in connection with the annual impairment tests performed on October 1, 2006, 2005 and 2004, and we do not believe that goodwill was impaired as of December 31, 2006. The trade name intangible asset will also be reviewed for impairment on an annual basis.

We make significant assumptions to estimate the future revenue and cash flows used to determine the fair value of our reporting units. These assumptions include future growth rates, profitability, discount factors, market comparables, future tax rates, and other factors. If the expected revenue and cash flows are not realized, or if a sustained significant depression in our market capitalization indicates that our assumptions are not accurately estimating our fair value, impairment losses may be recorded in the future.

#### *Stock-Based Compensation*

Effective January 1, 2006, we adopted FASB Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," referred to as SFAS 123R, using the modified prospective method, which requires that compensation expense be recorded for all unvested stock options at the beginning of the first quarter of adoption, and, accordingly, have not restated prior periods. SFAS 123R requires that the cost of all share-based payments to employees, including stock option grants, be recognized in the financial statements over the vesting period based on their fair values.

Determining the appropriate fair value model and calculating the fair value of share-based payment awards require the use of assumptions and estimates. The fair value of each stock option was estimated on the date of grant using the Black-Scholes option-pricing model, which uses assumptions including the expected life of the awards, stock price volatility, expected forfeiture rate and risk-free interest rate. Expected volatility was based on a blend of implied and historical volatility of the Company's predecessor common stock. We used historical data on exercises of stock options and other factors to estimate the expected term of the share-based payment awards granted. The risk free rate was based on the U.S. Treasury yield curve in effect at the date of grant.

On November 15, 2006, in connection with the Transaction and in accordance with the terms of the equity awards, the vesting of all outstanding unvested options to purchase the Company's stock and restricted stock units was accelerated, and we recorded compensation expense of approximately \$5.1 million for the acceleration.

#### *Revenue Recognition for Purchased Accounts Receivable*

In the ordinary course of accounting for purchased accounts receivable, estimates have been made by management as to the amount of future cash flows expected from each portfolio. We have historical collection records for all of our purchased accounts receivable, as well as debtor records since our entrance into this business and for acquired businesses since 1986, which provides us a reasonable basis for our judgment that it is probable that we will ultimately collect the recorded amount of our purchased accounts receivable plus a premium or yield. The historical collection amounts also provide a reasonable basis for determining the timing of the collections. We use all available information to forecast the cash flows of our purchased accounts receivable including, but not limited to, historical collections, payment patterns on similar purchases, credit scores of the underlying debtors, seller's credit policies, and location of the debtor. The estimated future cash flow of each portfolio is used to compute the internal rate of return, referred to as the IRR, for each portfolio. The IRR is used to allocate collections between revenue and amortization of the carrying values of the purchased accounts receivable.

We apply the American Institute of Certified Public Accountants Statement of Position 03-3 "Accounting for Certain Loans or Debt Securities Acquired in a Transfer," referred to as SOP 03-3. SOP 03-3 addresses accounting for differences between contractual versus expected cash flows over an investor's initial investment in certain loans when such differences are attributable, at least in part, to credit quality. SOP 03-3 does not allow the original estimate of the effective interest, or the IRR, to be lowered for revenue recognition or for subsequent testing for provision for impairments. If the original collection estimates are lowered, an allowance is established in the amount required to maintain the original IRR. If collection estimates are raised, increases are first used to recover any previously recorded allowances and then recognized prospectively through an increase in the IRR, which are realized over a portfolio's remaining life. Any increase in the IRR must be used for subsequent revenue recognition and allowance testing.

If management came to a different conclusion as to the future estimated collections, it could have had a significant impact on the amount of revenue that was recorded from the purchased accounts receivable during the year ended December 31, 2006. However, a five percent increase in the amount of future expected collections would have resulted in little or no change in net income for 2006, since increases in future expected collections are recognized over the portfolio's remaining life, and only to the extent sufficient to recover any allowances or to increase the expected IRR. A five percent decrease in the amount of future expected collections also would have resulted in little or no change in net income for 2006.

### *Allowance for Doubtful Accounts*

Allowances for doubtful accounts are estimated based on estimates of losses related to customer receivable balances. In establishing the appropriate provision for customer receivables balances, we make assumptions with respect to their future collectibility. Our assumptions are based on an individual assessment of a customer's credit quality as well as subjective factors and trends, including the aging of receivable balances. Generally, these individual credit assessments occur at regular reviews during the life of the exposure and consider factors such as a customer's ability to meet and sustain their financial commitments, a customer's current financial condition and historical payment patterns. Once the appropriate considerations referred to above have been taken into account, a determination is made as to the probability of default. An appropriate provision is made, which takes into account the severity of the likely loss on the outstanding receivable balance. Our level of reserves for our customer accounts receivable fluctuates depending upon all of the factors mentioned above, in addition to any contractual rights that allow us to reduce outstanding receivable balances through the application of future collections. If our estimate is not sufficient to cover actual losses, we would be required to take additional charges to our earnings.

### *Income Taxes*

We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," referred to as SFAS 109, which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance, if it is more likely than not that some portion or all of the deferred tax asset will not be realized. Deferred taxes have not been provided on the cumulative undistributed earnings of foreign subsidiaries because such amounts are expected to be reinvested indefinitely.

At December 31, 2006, our balance sheet included deferred tax assets of \$47.8 million for the assumed utilization of federal net operating loss carryforwards. We believe that we will be able to utilize the net operating loss carryforwards so we have not reduced the deferred tax asset by a valuation allowance. However, we have provided a \$21.7 million valuation allowance against the \$22.5 million deferred tax asset for state net operating loss carryforwards due to the uncertainty that they can be realized. The utilization of net operating loss carryforwards is an estimate based on a number of factors beyond our control, including the level of taxable income available from successful operations in the future. If we are unable to utilize the federal net operating loss carryforwards, it may result in incremental tax expense in future periods.

Our annual provision for income taxes and the determination of the resulting deferred tax assets and liabilities involve a significant amount of judgment and are based on the latest information available at the time. We are subject to audit within the federal, state and international taxing jurisdictions, and these audits can involve complex issues that may require an extended period of time to resolve. We maintain reserves for estimated tax exposures, which are ultimately settled primarily through the settlement of audits within these tax jurisdictions, changes in applicable tax law, or other factors. We believe that an appropriate liability has been established for financial statement purposes; however, actual results may differ from these estimates.

## Results of Operations

The following table sets forth selected historical statement of operations data (amounts in thousands):

|  | Combined           |        | Successor           | Predecessor  |                                  |        |            |        |
|--|--------------------|--------|---------------------|--------------|----------------------------------|--------|------------|--------|
|  |                    |        | Period from         | Period from  |                                  |        |            |        |
|  |                    |        | July 13, 2006       | January 1,   |                                  |        |            |        |
|  |                    |        | (date of inception) | 2006         |                                  |        |            |        |
|  | For the year ended |        | through             | through      | For the years ended December 31, |        |            |        |
|  | December 31, 2006  |        | December 31,        | November 15, | 2005                             |        | 2004       |        |
|  | Amount             | Ratio  | Amount              | Amount       | Amount                           | Ratio  | Amount     | Ratio  |
| Revenues                                     | \$ 1,190,097       | 100.0% | \$ 140,296          | \$ 1,049,801 | \$ 1,052,283                     | 100.0% | \$ 939,797 | 100.0% |
| Payroll and related expenses                 | 630,494            | 53.0   | 76,611              | 553,883      | 528,932                          | 50.3   | 472,915    | 50.3   |
| Selling, general and administrative expenses | 422,927            | 35.5   | 47,777              | 375,150      | 376,606                          | 35.8   | 324,187    | 34.5   |
| Restructuring charges                        | 12,765             | 1.1    | -                   | 12,765       | 9,621                            | 0.9    | -          | -      |
| Depreciation and amortization                | 58,243             | 4.9    | 11,548              | 46,695       | 45,787                           | 4.3    | 40,225     | 4.3    |
| Income from operations                       | 65,668             | 5.5    | 4,360               | 61,308       | 91,337                           | 8.7    | 102,470    | 10.9   |
| Other expense                                | 36,187             | 3.0    | 14,545              | 21,642       | 19,423                           | 1.9    | 17,612     | 1.9    |
| Income tax expense (benefit)                 | 10,965             | 0.9    | (3,777)             | 14,742       | 26,182                           | 2.5    | 32,389     | 3.4    |
| Minority interest                            | (4,047)            | 0.3    | (157)               | (3,890)      | (1,213)                          | 0.1    | (606)      | 0.1    |
| Net income (loss)                            | \$ 14,469          | 1.3%   | \$ (6,565)          | \$ 21,034    | \$ 44,519                        | 4.2%   | \$ 51,863  | 5.5%   |

### *Year ended December 31, 2006 Compared to Year ended December 31, 2005*

**Revenue.** Revenue increased \$137.8 million, or 13.1 percent, to \$1,190.1 million for 2006, from \$1,052.3 million in 2005. ARM, CRM and Portfolio Management accounted for \$866.0 million, \$251.2 million and \$187.0 million, respectively, of the 2006 revenue. ARM's revenue included \$113.7 million of intercompany revenue earned on services performed for Portfolio Management that was eliminated upon consolidation. CRM's revenue included \$363,000 of intercompany revenue earned on services performed for ARM that was eliminated upon consolidation.

ARM's revenue increased \$61.5 million, or 7.6 percent, to \$866.0 million in 2006, from \$804.5 million in 2005. The increase in ARM's revenue was primarily attributable to the acquisition of RMA in September 2005 as well as a \$26.4 million increase in fees from collection services performed for Portfolio Management, which was eliminated in consolidation. Included in ARM's intercompany service fees for the year ended December 31, 2006, was \$10.3 million of commissions from the sales of portions of older portfolios by Portfolio Management, compared to \$4.9 million in 2005.

CRM's revenue increased \$60.8 million, or 31.9 percent, to \$251.2 million in 2006, from \$190.4 million in 2005. The increase in CRM's revenue was primarily due to the implementation of new contracts that began during the second half of 2005 and into 2006. This was partially offset by the loss of business during 2006 from a telecommunications client resulting from changes in the telecommunications laws in 2004.

Portfolio Management's revenue increased \$31.6 million, or 23.8 percent, to \$164.2 million in 2006, from \$132.6 million in 2005. The increase primarily represents additional revenue from portfolio assets acquired throughout 2005 and during 2006, including the RMA portfolio and

Marlin portfolio acquisitions in September 2005. Portfolio Management's collections, excluding all portfolio sales, increased \$47.6 million, or 23.7 percent, to \$248.3 million in 2006, from \$200.7 million in 2005. Portfolio Management's revenue represented 67.3 percent of collections, excluding all portfolio sales, in 2006, as compared to 67.0 percent of collections, excluding all portfolio sales, in 2005.

In 2005, Portfolio Management began an on-going process to identify and sell certain aged and bankruptcy status portfolios of accounts receivable that have a low probability of payment under our collection platform and a low remaining carrying value. During 2006 and 2005, Portfolio Management recorded \$22.8 million and \$12.1 million, respectively, of revenue in connection with these sales.

***Payroll and related expenses.*** Payroll and related expenses increased \$101.6 million to \$630.5 million in 2006, from \$528.9 million in 2005, and increased as a percentage of revenue to 53.0 percent from 50.3 percent.

ARM's payroll and related expenses increased \$41.9 million to \$419.2 million in 2006, from \$377.3 million in 2005, and increased as a percentage of revenue to 48.4 percent from 46.9 percent. The increase in payroll and related expenses as a percentage of revenue was primarily due to the additional payroll expense from the acquisition of RMA, as well as \$7.1 million of stock-based compensation expense recorded in 2006 related to the adoption of SFAS 123R and the acceleration of the vesting of all outstanding unvested stock options and restricted stock units in connection with the Transaction.

CRM's payroll and related expenses increased \$57.7 million to \$203.6 million in 2006, from \$145.9 million in 2005, and increased as a percentage of revenue to 81.0 percent from 76.6 percent. The increase in payroll and related expenses as a percentage of revenue was primarily attributable to the upfront expense associated with implementing new clients in advance of generating the resulting revenue.

Portfolio Management's payroll and related expenses increased \$2.4 million to \$8.1 million in 2006, from \$5.7 million in 2005, and increased slightly as a percentage of revenue to 4.9 percent from 4.0 percent. Portfolio Management outsources all of the collection services to ARM and, therefore, has a relatively small fixed payroll cost structure. The increase in payroll and related expenses as a percentage of revenue was due principally to the acquisition of Marlin in September 2005.

***Selling, general and administrative expenses.*** Selling, general and administrative expenses increased \$46.3 million to \$422.9 million in 2006, from \$376.6 million in 2005, but decreased slightly as a percentage of revenue to 35.5 percent from 35.8 percent.

ARM's selling, general and administrative expenses increased \$31.9 million to \$368.9 million in 2006, from \$337.0 million in 2005, and increased as a percentage of revenue to 42.6 percent from 41.9 percent. Included in ARM's selling, general and administrative expenses for 2006 were charges of \$5.1 million related to the Transaction as well as charges of \$2.9 million related to the integration of the RMA acquisition. This compares to charges of \$1.5 million in 2005 related to the integration of RMA. Excluding these charges, ARM's selling, general and administrative expenses as a percentage of revenue for 2006 was essentially flat compared to 2005.

CRM's selling, general and administrative expenses increased \$9.2 million to \$44.7 million in 2006, from \$35.5 million in 2005, but decreased as a percentage of revenue to 17.8 percent from

18.6 percent. The decrease in selling, general and administrative expenses as a percentage of revenue was primarily attributable to the increased utilization of call center capacity as a result of the continuing implementation of new client contracts. This was offset partially by the upfront expenses required during the year to begin working for the new clients, such as facilities and telephone expense.

Portfolio Management's selling, general and administrative expenses increased \$31.5 million to \$123.0 million in 2006, from \$91.5 million in 2005, and increased as a percentage of revenue, not including revenue from the sales of portfolios, to 74.9 percent from 69.0 percent. The increase was due primarily to increased servicing fees related to the acquisitions of Marlin and RMA portfolios.

**Restructuring charges.** During 2006, we incurred restructuring charges of \$12.8 million related to the restructuring of our legacy operations to streamline our cost structure, in conjunction with the acquisition of RMA, compared to \$9.6 million in 2005. The charges consisted primarily of costs associated with the closing of redundant facilities and severance.

**Depreciation and amortization.** Depreciation and amortization increased to \$58.2 million in 2006, from \$45.8 million in 2005. This increase was primarily attributable to the amortization of the customer relationships acquired in connection with acquisitions in 2005 and the Transaction in November of 2006, as well as higher depreciation on additions to property and equipment during the end of 2005 and during 2006.

**Other income (expense).** Interest expense increased to \$41.6 million for 2006, from \$22.6 million for 2005. This increase was due primarily to the \$830.0 million of debt incurred in connection with the Transaction. Interest expense for 2006 also included \$3.2 million of Transaction related expenses. Other income (expense) for 2006 included \$2.3 million in insurance proceeds related to the effects of Hurricane Katrina on our business and approximately \$566,000 of net gains resulting from the settlement of certain foreign exchange contracts. Other income (expense) for 2005 included \$532,000 in recoveries of aged accounts receivable that had been written off by RMH prior to the acquisition and a \$93,000 gain from our ownership interest in one of our insurance carriers that was sold, offset in part by a \$595,000 write-down of an investment that has subsequently been sold for the adjusted carrying value.

**Income taxes.** The effective income tax rate increased to 37.2 percent in 2006 from 36.4 percent in 2005, which was primarily attributable to the effect on the prior year tax rate of losses in the CRM division and higher earnings from Portfolio Management, which is taxed at a lower rate.

#### ***Year ended December 31, 2005 Compared to Year ended December 31, 2004***

**Revenue.** Revenue increased \$112.5 million, or 12.0 percent, to \$1,052.3 million for 2005, from \$939.8 million in 2004. ARM, CRM and Portfolio Management accounted for \$804.5 million, \$190.4 million and \$144.7 million, respectively, of the 2005 revenue. ARM's revenue included \$87.3 million of intercompany revenue earned on services performed for Portfolio Management that was eliminated upon consolidation.

ARM's revenue increased \$58.3 million, or 7.8 percent, to \$804.5 million in 2005, from \$746.2 million in 2004. The increase in ARM's revenue was primarily attributable to the acquisition of RMA in September 2005 as well as an increase in fees from collection services performed for Portfolio Management. Included in ARM's intercompany service fees for the year

ended December 31, 2005, was \$4.9 million of commissions from the sales of portions of older portfolios by Portfolio Management. The increase in revenue was offset in part by lower revenue due to a more difficult collection environment in the second half of the year, which we attribute mainly to the effects of increased fuel costs on debtor's ability to pay on their accounts, and the inability to collect in the gulf coast region following Hurricanes Katrina and Rita.

CRM's revenue increased \$31.4 million, or 19.7 percent, to \$190.4 million in 2005, from \$159.0 million in 2004. The CRM division was formed in the second quarter of 2004 with the acquisition of RMH on April 2, 2004 and, accordingly, is only included in the results since that date. Partially offsetting the additional revenue in 2005 was the reduction in revenue from a telecommunications client where we ceased providing certain services following their decision to exit the consumer long-distance space due to a change in telecommunications laws in 2004.

Portfolio Management's revenue increased \$34.6 million, or 35.3 percent, to \$132.6 million in 2005, from \$98.0 million in 2004. Portfolio Management's collections, excluding portfolio resales, increased \$30.0 million, or 18.2 percent, to \$194.6 million in 2005, from \$164.6 million in 2004. Portfolio Management's revenue represented 67 percent of collections, excluding portfolio resales, in 2005, as compared to 59 percent of collections, excluding portfolio resales, in 2004. Revenue increased primarily due to additional revenue from portfolio assets acquired as part of two business combinations in the third quarter of 2005. Also contributing to the increase was better than expected collections on older portfolios and higher collections on fully cost recovered portfolios. Because these portfolios are fully cost recovered, 100 percent of the collections are applied to revenue.

In 2005, Portfolio Management began an on-going process to identify and sell certain aged portfolios of accounts receivable that have a very low probability of payment and a low remaining carrying value. During 2005, Portfolio Management recorded \$12.1 million of revenue in connection with these sales.

***Payroll and related expenses.*** Payroll and related expenses increased \$56.0 million to \$528.9 million in 2005, from \$472.9 million in 2004, but remained flat as a percentage of revenue at 50.3 percent.

ARM's payroll and related expenses increased \$20.2 million to \$377.3 million in 2005, from \$357.1 million in 2004, but decreased as a percentage of revenue to 46.9 percent from 47.9 percent. The decrease in payroll and related expenses as a percentage of revenue was primarily due to continued diligence in monitoring staffing levels in line with current results, as well as the use of offshore labor, outside attorneys and other agencies. Included in ARM's payroll and related expenses for 2005, were charges of \$419,000 related to the integration of the RMA acquisition and \$164,000 related to Hurricane Katrina.

CRM's payroll and related expenses increased \$32.2 million to \$145.9 million in 2005, from \$113.7 million in 2004, and increased as a percentage of revenue to 76.6 percent from 71.5 percent. The increase in payroll and related expenses as a percentage of revenue was primarily attributable to the upfront expense associated with implementing new clients in advance of generating the resulting revenue.

Portfolio Management's payroll and related expenses increased \$3.6 million to \$5.7 million in 2005, from \$2.1 million in 2004, and increased as a percentage of revenue to 4.0 percent from 2.1 percent. Portfolio Management outsources all of the collection services to ARM and, therefore, has a relatively small fixed payroll cost structure. The increase in payroll and related expenses as a

percentage of revenue was due to an increase in the allocation of payroll and related expenses from corporate shared services.

***Selling, general and administrative expenses.*** Selling, general and administrative expenses increased \$52.4 million to \$376.6 million in 2005, from \$324.2 million in 2004, and increased as a percentage of revenue to 35.8 percent from 34.5 percent.

ARM's selling, general and administrative expenses increased \$41.6 million to \$337.0 million in 2005, from \$295.4 million in 2004, and increased as a percentage of revenue to 41.9 percent from 39.6 percent. The increase was due primarily to an increase in the use of outside collection attorneys and other third-party service providers. Included in ARM's selling, general and administrative expenses for 2005, were charges of \$1.4 million related to the integration of the RMA acquisition, and \$306,000 related to Hurricane Katrina.

CRM's selling, general and administrative expenses increased \$8.8 million to \$35.5 million in 2005, from \$26.7 million in 2004, and increased as a percentage of revenue to 18.6 percent from 16.8 percent. The increase was primarily attributable to the start-up of new clients in this division. We incur the upfront expenses required to begin working for a new client, such as facilities and telephone expense, before we start generating the offsetting revenue.

Portfolio Management's selling, general and administrative expenses increased \$25.9 million to \$91.5 million in 2005, from \$65.6 million in 2004, and increased as a percentage of revenue, not including revenue from the sales of portfolios, to 69.0 percent from 66.9 percent. The increase was due primarily to increased servicing fees related to the acquisitions of Marlin and RMA.

***Restructuring charges.*** During 2005, we incurred restructuring charges of \$9.6 million related to the restructuring of our legacy operations to streamline our cost structure, in conjunction with the acquisition of RMA. The charges consisted primarily of costs associated with the closing of redundant facilities and severance.

***Depreciation and amortization.*** Depreciation and amortization increased to \$45.8 million in 2005, from \$40.2 million in 2004. This increase was primarily attributable to the amortization of the customer relationships acquired in connection with acquisitions in 2005 and the acquisition of RMH in April of 2004. The remainder of the increase was attributable to higher depreciation on additions to property and equipment during 2005 as well as the depreciation on the property and equipment acquired in the RMH and RMA acquisitions.

***Other income (expense).*** Interest and investment income included investment income of \$377,000 for 2005, as compared to \$1.6 million for 2004, from the 50 percent ownership interest in a joint venture that we had with Marlin prior to the acquisition of the remaining 50 percent ownership in September 2005. The decrease from last year also reflects the joint venture's lower revenue due to decreased purchases of accounts receivable during the second half of 2004 and into 2005, related to the winding down of the joint venture. Interest expense increased to \$22.6 million for 2005, from \$21.2 million for 2004. This increase was due to higher principal balances as a result of borrowings made against the senior credit facility for the acquisitions in September 2005, higher interest rates, and Portfolio Management's additional nonrecourse borrowings to purchase accounts receivable. Other income (expense) for 2005 included \$532,000 in recoveries of aged accounts receivable that had been written off by RMH prior to the acquisition and a \$93,000 gain from our ownership interest in one of our insurance carriers that was sold, offset in part by a \$595,000 write-down of an investment that has subsequently been sold for the adjusted carrying value. Other income (expense) for 2004 included \$621,000 of proceeds from an

insurance policy related to a deferred compensation plan assumed as part of the acquisition of FCA International Ltd. in May 1998, and \$157,000 in losses on the disposal of fixed assets and other net assets.

**Income taxes.** The effective income tax rate decreased to 36.4 percent from 38.2 percent due mainly to losses in the CRM division as well as higher earnings from Portfolio Management, which is taxed at a lower rate than the ARM business.

### **Liquidity and Capital Resources**

Our primary sources of cash have been cash flows from operations, bank borrowings, nonrecourse borrowings and debt offerings. Cash has been used for acquisitions, repayments of bank borrowings, purchases of equipment, purchases of accounts receivable, and working capital to support our growth.

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

The cash flow from our contingency collection business and our purchased portfolio business is dependent upon our ability to collect from consumers and businesses. Many factors, including the economy and our ability to hire and retain qualified collectors and managers, are essential to our ability to generate cash flows. Fluctuations in these trends that cause a negative impact on our business could have a material impact on our expected future cash flows.

In connection with the Transaction on November 15, 2006, we repaid the Predecessor senior credit facility and entered into a new senior credit facility, referred to as the Credit Facility, to, in part, finance the Transaction and certain related costs and expenses. The Credit Facility consists of a \$465.0 million term loan and a \$100.0 million revolving credit facility.

Additionally, in connection with the Transaction, on November 15, 2006 we issued \$165.0 million of floating rate senior notes and \$200.0 million of 11 $\frac{7}{8}$  percent senior subordinated notes. As a result of the Transaction, we are significantly leveraged.

**Cash Flows from Operating Activities.** Cash provided by operating activities was \$100.4 million in 2006, compared to \$89.6 million in 2005. The increase in cash provided by operating activities was primarily attributable to a \$23.5 million increase in income taxes payable in 2006, compared to a \$19.7 million decrease in the prior year related to a lower tax rate due to losses in the CRM division and higher profits from Portfolio Management, which are taxed at a lower rate. Also contributing to the increase in 2006 was an increase in trade accounts receivable of \$18.5 million for 2005 due to increased billings to new clients in that year. These items were partially offset by a \$2.2 million increase in other assets in 2006 compared to a \$13.6 million decrease in 2005, primarily resulting from the settlement of a long-term collection contract in 2005, as well as a decrease in net income for 2006.

Cash provided by operating activities was \$89.6 million in 2005, compared to \$99.0 million in 2004. The decrease in cash provided by operating activities was due to an increase in trade accounts receivable of \$18.5 million compared to an increase of \$2.7 million in the prior year,

primarily related to increased billings to new clients. Also contributing to the decrease was a decrease in income taxes payable of \$19.7 million compared to an increase of \$545,000 for 2004, related to a lower tax rate due to losses in the CRM division and higher profits from Portfolio Management, which are taxed at a lower rate. These items were partially offset by a decrease in other assets of \$13.6 million compared to an increase of \$15.8 million for 2004, related to the settlement of a long-term collection contract.

***Cash Flows from Investing Activities.*** Cash used in investing activities was \$1,001.8 million in 2006, compared to \$189.5 million in 2005. The increase in cash used in investing activities was primarily attributable to cash paid for acquisitions and acquisition-related costs of \$983.2 million in 2006 primarily incurred in connection with the Transaction and the acquisition of Star Contact. Also contributing to the increase was an increase in purchases of accounts receivable, offset in part by increases in collections applied to purchased accounts receivable and proceeds from sales and resales of purchased accounts receivable. Cash flows from investing activities for 2005 did not include \$17.2 million of Portfolio Management's purchases of large accounts receivable portfolios financed through an agreement we have with a lender. The purchases were noncash transactions as the lender sent borrowings directly to the seller of the accounts (see note 16 to our Notes to Consolidated Financial Statements).

Cash used in investing activities was \$189.5 million in 2005, compared to \$1.5 million in 2004. The increase in cash used in investing activities was primarily attributable to cash paid for acquisitions and acquisition-related costs of \$118.9 million and \$88.4 million incurred in connection with the acquisitions of RMA and Marlin, respectively, and higher purchases of property and equipment in 2005, primarily in the CRM division due to the start-up of new clients. These increases were partially offset by the \$32.5 million minority interest investment in the Marlin acquisition by our nonrecourse lender. Cash flows from investing activities for 2005 and 2004 did not include \$17.2 million and \$42.8 million, respectively, of Portfolio Management's purchases of large accounts receivable portfolios financed through an agreement we have with a lender. The purchases were noncash transactions as the lender sent borrowings directly to the seller of the accounts (see note 16 to our Notes to Consolidated Financial Statements).

***Cash Flows from Financing Activities.*** Cash provided by financing activities was \$910.6 million in 2006, compared to \$97.6 million in 2005. The increase in cash provided by financing activities during 2006 resulted from the borrowings of \$830.0 million to fund the Transaction, consisting of the \$465.0 million term loan under the senior credit facility, \$165.0 million of senior notes and \$200.0 million of senior subordinated notes. Also contributing to the increase was the issuance of \$396.0 million of capital stock in connection with the Transaction. Partially offsetting these items was the repayments of Predecessor borrowings under the revolving credit agreement and convertible notes. Cash flows from financing activities for 2005 did not include \$17.2 million of Portfolio Management's borrowings under nonrecourse debt, used to purchase large accounts receivable portfolios financed through an agreement we have with a lender. These borrowings were noncash transactions as the lender sent borrowings directly to the seller of the accounts (see note 16 to our Notes to Consolidated Financial Statements).

Cash provided by financing activities was \$97.6 million in 2005, compared to cash used in financing activities of \$119.5 million in 2004. The increase in cash provided by financing activities during 2005 resulted from the borrowings of \$155.5 million under the revolving credit agreement to fund the acquisitions of Marlin and RMA, as well as borrowings under nonrecourse debt for the acquisition of RMA's purchase portfolio assets. The lower repayments of borrowings under the revolving credit agreement during 2005, compared to the prior year was due to the use of cash to pay for acquisitions and fund the growth in the CRM division. Cash flows from financing

activities for 2005 and 2004 did not include \$17.2 million and \$42.8 million, respectively, of Portfolio Management's borrowings under nonrecourse debt, used to purchase large accounts receivable portfolios financed through an agreement we have with a lender. These borrowings were noncash transactions as the lender sent borrowings directly to the seller of the accounts (see note 16 to our Notes to Consolidated Financial Statements).

**Senior Credit Facility.** In connection with the Transaction, on November 15, 2006 we repaid the Predecessor senior credit facility and entered into a new senior credit facility, referred to as the Credit Facility, with a syndicate of financial institutions. The Credit Facility consists of a \$465.0 million term loan and a \$100.0 million revolving credit facility, with an option to allow us to increase our borrowing capacity under the revolving credit facility to a maximum of \$200.0 million, subject to obtaining commitments for such capacity from existing or new lenders. A portion of the revolving credit facility is available for letters of credit and swingline loans, each not to exceed \$20.0 million. We are required to make quarterly repayments of \$1.2 million on the term loan until the maturity date of May 15, 2013, at which time the remaining balance outstanding is due. We are also required to make annual prepayments, beginning in 2007, of 50 percent, 25 percent or zero percent of our excess annual cash flow, based on our leverage ratio. The revolving credit facility requires no minimum principal payments until its maturity date of November 15, 2011. At December 31, 2006, the balance outstanding on the revolving credit facility was \$36.0 million. The availability of the revolving credit facility is reduced by any unused letters of credit (\$4.8 million at December 31, 2006). As of December 31, 2006, we had \$59.2 million of remaining availability under the revolving credit facility.

Borrowings under the Credit Facility are collateralized by substantially all of our assets. The Credit Facility contains certain financial and other covenants such as maintaining a maximum leverage ratio and a minimum interest coverage ratio, and includes restrictions on, among other things, acquisitions, the incurrence of additional debt, investments, disposition of assets, liens and dividends and other distributions. If an event of default, such as failure to comply with covenants or change of control, were to occur under the Credit Facility, the lenders would be entitled to declare all amounts outstanding under it immediately due and payable and foreclose on the pledged assets. We were not able to satisfy the covenants under the Credit Facility to provide our annual financial statements for the year ended December 31, 2006 and the annual forecasts for the year ended December 31, 2007 within their respective deadlines. We obtained a waiver for these covenants from the lenders, and as of December 31, 2006, we were in compliance with all required financial covenants and we were not aware of any other events of default.

**Senior Notes and Senior Subordinated Notes.** In connection with the Transaction, on November 15, 2006 we issued \$165.0 million of floating rate senior notes due 2013, referred to as the Senior Notes, and \$200.0 million of 11 $\frac{7}{8}$  percent senior subordinated notes due 2014, referred to as the Senior Subordinated Notes, collectively referred to as the Notes. The Notes are guaranteed, jointly and severally, on a senior basis with respect to the Senior Notes and on a senior subordinated basis with respect to the Senior Subordinated Notes, in each case by all of our existing and future domestic restricted subsidiaries (other than certain subsidiaries and joint ventures engaged in financing the purchase of delinquent accounts receivable portfolios).

The Senior Notes are senior unsecured obligations and are senior in right of payment to all existing and future senior subordinated indebtedness, including the Senior Subordinated Notes, and all future subordinated indebtedness. The Senior Notes bear interest at a rate equal to LIBOR plus 4.875 percent, reset quarterly. We may redeem the Senior Notes, in whole or in part, at any time on or after November 15, 2008 at varying redemption prices depending on the redemption date, plus accrued and unpaid interest.

The Senior Subordinated Notes are unsecured senior subordinated obligations and are subordinated in right of payment to all existing and future senior indebtedness, including the Senior Notes and borrowings under the Credit Facility. We may redeem the Senior Subordinated Notes, in whole or in part, at any time on or after November 15, 2010 at varying redemption prices depending on the redemption date, plus accrued and unpaid interest.

The indentures governing the Notes contain a number of covenants that limit our and our restricted subsidiaries' ability, among other things, to: incur additional indebtedness and issue certain preferred stock, pay certain dividends, acquire shares of capital stock, make payments on subordinated debt or make investments, place limitations on distributions from restricted subsidiaries, guarantee indebtedness, sell or exchange assets, enter into transactions with affiliates, create certain liens, engage in unrelated businesses, and consolidate, merge or transfer all or substantially all of our assets and the assets of our subsidiaries on a consolidated basis. In addition, upon the change of control, we are required to offer to repurchase all of the Notes then outstanding, at a purchase price equal to 101 percent of their principal amount, plus any accrued interest to the date of repurchase.

***Nonrecourse Credit Facility.*** On June 30, 2005, our subsidiary, Portfolio Management amended and restated its nonrecourse credit facility with a lender and extended its existing exclusivity agreement with such lender through June 30, 2009. The new agreement provides that all purchases of accounts receivable by Portfolio Management with a purchase price in excess of \$1.0 million are first offered to the lender for financing at its discretion. If the lender chooses to participate in the financing of a portfolio of accounts receivable, the financing may be structured, depending on the size and nature of the portfolio to be purchased, either as a borrowing arrangement similar to the original agreement, or under various equity sharing arrangements ranging from 25 percent to 50 percent equity provided by the lender. The lender will finance non-equity borrowings at 70 percent of the purchase price, unless otherwise negotiated, with floating interest at a rate equal to LIBOR plus 2.50 percent. As additional return on the debt financed portfolios, the lender receives a percentage of the residual cash flow, unless otherwise negotiated, which is defined as all cash collections after servicing fees, floating rate interest, repayment of the borrowing, and the initial investment by Portfolio Management, including interest. These borrowings are nonrecourse to us and are due two years from the date of each respective loan. We may terminate the agreement at any time after June 2007 for a cost of \$250,000 for each remaining month under the new agreement. The previous financing arrangement as described below remains in effect for outstanding loans as of June 30, 2005. Total debt outstanding under this facility as of December 31, 2006, was \$51.0 million, including \$13.6 million of accrued residual interest. As of December 31, 2006, Portfolio Management was in compliance with all of the financial covenants.

Under the prior agreement, borrowings carry interest at the prime rate plus 3.25 percent and are nonrecourse to us, except for the assets financed through the lender. Debt service payments equal total collections less servicing fees and expenses until each individual borrowing is fully repaid and Portfolio Management's original investment is returned, including interest. Thereafter, the lender is paid a residual of 40 percent of collections, less servicing costs, unless otherwise negotiated. Individual loans are required to be repaid based on collections, but not more than two years from the date of borrowing. This loan agreement contains a collections performance requirement, among other covenants, that, if not met, provides for cross-collateralization with any other portfolios financed through the agreement, in addition to other remedies.

As part of the exclusivity agreement described above, Portfolio Management has a joint venture agreement with the lender to purchase larger portfolios, whereby Portfolio Management owns 65 percent and is the managing member, and the lender owns the remaining 35 percent

interest. Each party finances the joint venture based on predetermined percentages as negotiated for each portfolio purchase. The joint venture agreement was established to purchase accounts receivable at the discretion of Portfolio Management, and the joint venture is consolidated into Portfolio Management's results of operations with a minority interest representing the lender's equity ownership. At December 31, 2006, we had \$12.2 million of debt outstanding under the joint venture, which is included in the nonrecourse credit facility debt outstanding disclosed above.

**Contractual Obligations.** The following summarizes our contractual obligations as of December 31, 2006 (amounts in thousands). For a detailed discussion of these contractual obligations, see notes 10, 11 and 18 in our Notes to Consolidated Financial Statements.

|                                 | <b>Payments Due by Period<sup>(1)</sup></b> |                             |                         |                         |                              |
|---------------------------------|---|-----------------------------|-------------------------|-------------------------|------------------------------|
|                                 | <b>Total</b>                                | <b>Less than<br/>1 Year</b> | <b>1 to 3<br/>Years</b> | <b>3 to 5<br/>Years</b> | <b>More than<br/>5 Years</b> |
| Credit Facility                 | \$ 501,000                                  | \$ 4,650                    | \$ 9,300                | \$ 45,300               | \$ 441,750                   |
| Notes                           | 365,000                                     | -                           | -                       | -                       | 365,000                      |
| Nonrecourse credit facility     | 50,952                                      | 31,322                      | 11,951                  | 7,565                   | 114                          |
| Other long-term debt            | 1,361                                       | 720                         | 365                     | 167                     | 109                          |
| Operating leases <sup>(2)</sup> | 210,933                                     | 44,059                      | 73,586                  | 54,456                  | 38,832                       |
| Purchase commitments            | 60,443                                      | 43,324                      | 17,119                  | -                       | -                            |
| Forward flow agreements         | 101,616                                     | 39,901                      | 44,997                  | 16,718                  | -                            |
| Total contractual obligations   | <u>\$ 1,291,305</u>                         | <u>\$ 163,976</u>           | <u>\$ 157,318</u>       | <u>\$ 124,206</u>       | <u>\$ 845,805</u>            |

(1) Does not include deferred income taxes since the timing of payment is not certain (see note 12 in our Notes to Consolidated Financial Statements). Payments of debt do not include interest expense.

(2) Does not include the leases from our former Fort Washington locations (see note 18 in our Notes to Consolidated Financial Statements).

### **Off-Balance Sheet Arrangements**

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

### **Market Risk**

We are exposed to various types of market risk in the normal course of business, including the impact of interest rate changes, foreign currency exchange rate fluctuations, changes in corporate tax rates and inflation. We employ risk management strategies that may include the use of derivatives, such as interest rate cap agreements, interest rate swap agreements and foreign currency forwards and options to manage these exposures.

**Foreign Currency Risk.** Foreign currency exposures arise from transactions denominated in a currency other than the functional currency and from foreign denominated revenue and profit translated into U.S. dollars. The primary currencies to which we are exposed include the Canadian dollar, the British pound, the Australian dollar and the Philippine peso. Due to the growth of the Canadian operations, we currently use forward exchange contracts to limit potential losses in earnings or cash flows from adverse foreign currency exchange rate movements. These contracts are entered into to protect against the risk that the eventual cash flows resulting from such contracts will be adversely affected by changes in exchange rates. Our objective is to maintain economically balanced currency risk management strategies that provide adequate downside protection. A five percent increase or decrease in the Canadian exchange rate could have an annual impact of approximately \$4.0 million on our business, excluding the impact of foreign currency hedges.

**Interest Rate Risk.** At December 31, 2006, we had \$717.0 million in outstanding variable rate borrowings. A material change in interest rates could adversely affect our operating results and cash flows. A 25 basis-point increase in interest rates could increase our annual interest expense by \$125,000 for each \$50 million of variable debt outstanding for the entire year. We currently use interest rate cap agreements to limit potential losses from adverse interest rate changes.

### **Impact of Recently Issued and Proposed Accounting Pronouncements**

**FASB Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment.”** In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment,” which requires that the cost of all share-based payments to employees, including stock option grants, be recognized in the financial statements based on their fair values. The standard applies to newly granted awards and previously granted awards that are not fully vested on the date of adoption. We adopted the standard on January 1, 2006 using the modified prospective method (see note 2 in our Notes to Consolidated Financial Statements).

**FASB Statement of Financial Accounting Standards No. 154, “Accounting Changes and Error Corrections – a replacement of APB Opinion No. 20 and FASB Statement No. 3.”** In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, “Accounting Changes and Error Corrections – a replacement of APB Opinion No. 20 and FASB Statement No. 3”, referred to as SFAS 154, which replaces APB Opinion No. 20, “Accounting Changes,” and SFAS No. 3, “Reporting Accounting Changes in Interim Financial Statements,” and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS 154 applies to all voluntary changes in accounting principles. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. It does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of SFAS 154. We adopted SFAS 154 on January 1, 2006, and it did not have a material impact on our financial statements.

**FASB Statement of Financial Accounting Standards No. 155, “Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140.”** In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, “Accounting for Certain Hybrid Financial Instruments,” referred to as SFAS 155. This statement amends SFAS No. 133 “Accounting for Derivative Instruments and Hedging Activities” and SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.” SFAS 155 permits fair value remeasurement for hybrid financial instruments that contain embedded derivatives that would require separate accounting. In addition, the statement establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain embedded derivatives. SFAS 155 is effective for all financial instruments acquired or issued beginning after an entity’s fiscal year beginning on September 15, 2006 with earlier adoption permitted. We adopted SFAS 155 on November 16, 2006, and it did not have a material impact on our financial statements.

**FASB Statement of Financial Accounting Standards No. 156, “Accounting for Servicing of Financial Assets – an Amendment of FASB Statement No. 140.”** In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, “Accounting for Servicing of Financial Assets – an Amendment of FASB Statement No. 140,” referred to as SFAS 156. This

statement amends SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.” SFAS 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable, and provides two methods for the subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. This statement is effective for fiscal years beginning after September 15, 2006. We are currently evaluating the statement and do not believe the adoption of SFAS 156 will have a material impact on our financial statements.

***FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes.”*** In July 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes,” referred to as FIN 48, which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize in our consolidated financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We have not completed our review and assessment of the impact of the adoption of FIN 48.

***FASB Statement of Financial Accounting Standards No. 157, “Fair Value Measurements.”*** In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, “Fair Value Measurements,” referred to as SFAS 157. This statement defines fair value and provides guidance for measuring assets and liabilities at fair value. This statement also expands the disclosure requirements about the use of fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. We have not completed our review and assessment of the impact of the adoption of SFAS 157.

## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

|  |     |
|--|-----|
| Reports of Independent Auditors.....                 | F-2 |
| Consolidated Balance Sheets.....                     | F-4 |
| Consolidated Statements of Operations .....          | F-5 |
| Consolidated Statements of Stockholders' Equity..... | F-6 |
| Consolidated Statements of Cash Flows.....           | F-7 |
| Notes to Consolidated Financial Statements.....      | F-8 |

## **Report of Independent Auditors**

The Board of Directors and Stockholders of  
NCO Group, Inc.:

We have audited the accompanying consolidated balance sheet of NCO Group, Inc. (formerly known as Collect Holdings, Inc.) as of December 31, 2006 and the related consolidated statements of operations, stockholders' equity, and cash flows for the period July 13, 2006 (date of inception) to December 31, 2006 (Successor Period). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Collect Holdings Inc. (as successor to NCO Group, Inc.) at December 31, 2006, and the consolidated results of its operations and its cash flows for the period July 13, 2006 (date of inception) to December 31, 2006 in conformity with accounting principles generally accepted in the United States.

/s/ Ernst & Young, LLP

Philadelphia, Pennsylvania  
May 8, 2007

## Report of Independent Auditors

The Board of Directors and Stockholders of  
NCO Group, Inc.:

We have audited the accompanying consolidated balance sheet of NCO Group, Inc. (as predecessor to Collect Holdings, Inc.) as of December 31, 2005 and the related consolidated statements of operations, stockholders' equity, and cash flows for the years ended December 31, 2005 and 2004 and for the period from January 1, 2006 to November 15, 2006 (collectively the Predecessor Period). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of NCO Group, Inc. (as predecessor to Collect Holdings, Inc.) at December 31, 2005, and the consolidated results of its operations and its cash flows for the years ended December 31, 2005 and 2004 and for the period from January 1, 2006 to November 15, 2006 (collectively the Predecessor Period), in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share-Based Payment*, on January 1, 2006.

/s/ Ernst & Young, LLP

Philadelphia, Pennsylvania  
May 8, 2007

**NCO GROUP, INC.**  
**Consolidated Balance Sheets**  
(Amounts in thousands, except per share amounts)

| ASSETS  | <u>Successor</u><br><u>December 31,</u><br><u>2006</u> | <u>Predecessor</u><br><u>December 31,</u><br><u>2005</u> |
|---|--|--|
| Current assets:   |  |  |
| Cash and cash equivalents   | \$ 13,899  | \$ 23,716  |
| Accounts receivable, trade, net of allowance for doubtful accounts of \$ - and \$8,079, respectively                                | 143,933  | 143,019  |
| Purchased accounts receivable, current portion, net of allowance for impairment of \$ - and \$1,192, respectively                   | 147,303  | 102,779  |
| Deferred income taxes   | 9,646  | 10,918   |
| Prepaid expenses and other current assets   | 29,580   | 42,854   |
| Total current assets  | <u>344,361</u>   | <u>323,286</u>   |
| Funds held on behalf of clients   |  |  |
| Property and equipment, net   | 135,931  | 131,370  |
| Other assets:   |  |  |
| Goodwill  | 600,546  | 668,832  |
| Trade name  | 96,613   | -  |
| Customer relationships and other intangible assets, net of accumulated amortization   | 320,901  | 41,695   |
| Purchased accounts receivable, net of current portion   | 96,797   | 135,028  |
| Deferred income taxes   | 5,815  | 4,737  |
| Other assets  | 43,175   | 23,014   |
| Total other assets  | <u>1,163,847</u>                                       | <u>873,306</u>   |
| Total assets  | <u>\$ 1,644,139</u>                                    | <u>\$ 1,327,962</u>                                      |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |  |  |
| Current liabilities:  |  |  |
| Long-term debt, current portion   | \$ 36,692  | \$ 45,600  |
| Income taxes payable  | 6,987  | 4,531  |
| Accounts payable  | 11,593   | 12,372   |
| Accrued expenses  | 73,781   | 63,076   |
| Accrued compensation and related expenses   | 34,021   | 26,120   |
| Total current liabilities   | <u>163,074</u>   | <u>151,699</u>   |
| Funds held on behalf of clients   |  |  |
| Long-term liabilities:  |  |  |
| Long-term debt, net of current portion  | 881,621  | 321,834  |
| Deferred income taxes   | 144,743  | 57,709   |
| Other long-term liabilities   | 10,752   | 18,963   |
| Minority interest   | 55,628   | 34,643   |
| Commitments and contingencies   |  |  |
| Stockholders' equity:   |  |  |
| Predecessor:  |  |  |
| Preferred stock, no par value, 5,000 shares authorized, no shares issued and outstanding  | -  | -  |
| Common stock, no par value, 50,000 shares authorized, 32,176 shares issued and outstanding at December 31, 2005                     | -  | 477,238  |
| Successor:  |  |  |
| Preferred stock, par value \$0.01 per share, 6,000 shares authorized, 1,220 shares issued and outstanding at December 31, 2006      | 12   | -  |
| Class L common stock, par value \$0.01 per share, 400 shares authorized, 364 shares issued and outstanding at December 31, 2006     | 4  | -  |
| Class A common stock, par value \$0.01 per share, 2,750 shares authorized, 1,616 shares issued and outstanding at December 31, 2006 | 18   | -  |
| Additional paid-in capital  | 396,015  | -  |
| Other comprehensive (loss) income   | (1,163)  | 13,892   |
| Deferred compensation   | -  | (4,658)  |
| (Accumulated deficit) retained earnings   | (6,565)  | 256,642  |
| Total stockholders' equity  | <u>388,321</u>   | <u>743,114</u>   |
| Total liabilities and stockholders' equity  | <u>\$ 1,644,139</u>                                    | <u>\$ 1,327,962</u>                                      |

See accompanying notes.

**NCO GROUP, INC.**  
**Consolidated Statements of Operations**  
(Amounts in thousands)

|  | <u>Successor</u>   | <u>Predecessor</u>  |   |   |
|--|--|---|---|---|
|  | <u>Period from<br/>July 13, 2006<br/>(date of inception)<br/>through<br/>December 31,<br/>2006</u> | <u>Period from<br/>January 1,<br/>through<br/>November 15,<br/>2006</u> | <u>Year ended<br/>December 31,<br/>2005</u> | <u>Year ended<br/>December 31,<br/>2004</u> |
| Revenues:                                    |  |   |   |   |
| Services                                     | \$ 126,739   | \$ 875,338  | \$ 906,258                                  | \$ 840,346                                  |
| Portfolio                                    | 13,557   | 151,706   | 133,868                                     | 99,451                                      |
| Portfolio sales                              | -  | 22,757  | 12,157                                      | -   |
| Total revenues                               | <u>140,296</u>   | <u>1,049,801</u>  | <u>1,052,283</u>                            | <u>939,797</u>                              |
| Operating costs and expenses:                |  |   |   |   |
| Payroll and related expenses                 | 76,611   | 553,883   | 528,932                                     | 472,915                                     |
| Selling, general and administrative expenses | 47,777   | 375,150   | 376,606                                     | 324,187                                     |
| Restructuring charges                        | -  | 12,765  | 9,621                                       | -   |
| Depreciation and amortization expense        | 11,548   | 46,695  | 45,787                                      | 40,225                                      |
| Total operating costs and expenses           | <u>135,936</u>   | <u>988,493</u>  | <u>960,946</u>                              | <u>837,327</u>                              |
| Income from operations                       | <u>4,360</u>   | <u>61,308</u>   | <u>91,337</u>                               | <u>102,470</u>                              |
| Other income (expense):                      |  |   |   |   |
| Interest and investment income               | 300  | 1,836   | 3,162                                       | 3,185                                       |
| Interest expense                             | (14,958)   | (26,643)  | (22,615)                                    | (21,244)                                    |
| Other (expense) income                       | 113  | 3,165   | 30  | 447   |
| Total other income (expense)                 | <u>(14,545)</u>  | <u>(21,642)</u>   | <u>(19,423)</u>                             | <u>(17,612)</u>                             |
| (Loss) income before income tax expense      | <u>(10,185)</u>  | <u>39,666</u>   | <u>71,914</u>                               | <u>84,858</u>                               |
| Income tax (benefit) expense                 | <u>(3,777)</u>   | <u>14,742</u>   | <u>26,182</u>                               | <u>32,389</u>                               |
| (Loss) income before minority interest       | <u>(6,408)</u>   | <u>24,924</u>   | <u>45,732</u>                               | <u>52,469</u>                               |
| Minority interest                            | <u>(157)</u>   | <u>(3,890)</u>  | <u>(1,213)</u>                              | <u>(606)</u>                                |
| Net (loss) income                            | <u>\$ (6,565)</u>  | <u>\$ 21,034</u>  | <u>\$ 44,519</u>                            | <u>\$ 51,863</u>                            |

See accompanying notes.

**NCO GROUP, INC.**  
**Consolidated Statements of Stockholders' Equity**  
(Amounts in thousands)

|  | Preferred<br>Stock | Class L<br>Common<br>Stock | Class A<br>Common<br>Stock | Additional<br>Paid-in<br>Capital | Common<br>Stock   | Other<br>Comprehensive<br>Income (Loss) | Deferred<br>Compensation | Retained<br>Earnings<br>(Accumulated<br>Deficit) | Comprehensive<br>Income (Loss) | Total             |
|--|--------------------|----------------------------|----------------------------|----------------------------------|-------------------|---|--------------------------|--|--------------------------------|-------------------|
| <b>Predecessor</b>   |                    |                            |                            |                                  |                   |   |                          |  |                                |                   |
| Balance, January 1, 2004   |                    |                            |                            |                                  | \$ 323,511        | \$ 6,646                                | \$ -                     | \$ 160,260                                       |                                | \$ 490,417        |
| Issuance of common stock in connection with acquisitions   |                    |                            |                            |                                  | 128,699           | -                                       | -                        | -  |                                | 128,699           |
| Issuance of common stock in connection with stock option plans                                     |                    |                            |                            |                                  | 16,763            | -                                       | -                        | -  |                                | 16,763            |
| Exercise of common stock warrants  |                    |                            |                            |                                  | 296               | -                                       | -                        | -  |                                | 296               |
| Issuance of restricted stock   |                    |                            |                            |                                  | 4,141             | -                                       | (4,141)                  | -  |                                | -                 |
| Amortization of deferred compensation  |                    |                            |                            |                                  | -                 | -                                       | 683                      | -  |                                | 683               |
| Comprehensive income, net of tax:  |                    |                            |                            |                                  |                   |   |                          |  |                                |                   |
| Net income   |                    |                            |                            |                                  | -                 | -                                       | -                        | 51,863   | \$ 51,863                      | 51,863            |
| Other comprehensive income (loss):   |                    |                            |                            |                                  |                   |   |                          |  |                                |                   |
| Foreign currency translation adjustment  |                    |                            |                            |                                  | -                 | 6,593                                   | -                        | -  | 6,593                          | 6,593             |
| Change in fair value of foreign currency cash flow hedge, net of taxes of \$158                    |                    |                            |                            |                                  | -                 | 287                                     | -                        | -  | 287                            | 287               |
| Total comprehensive income   |                    |                            |                            |                                  |                   |   |                          |  | <u>\$ 58,743</u>               |                   |
| <b>Balance, December 31, 2004</b>  |                    |                            |                            |                                  | <u>473,410</u>    | <u>13,526</u>                           | <u>(3,458)</u>           | <u>212,123</u>                                   |                                | <u>695,601</u>    |
| Issuance of common stock in connection with stock-based compensation plans                         |                    |                            |                            |                                  | 1,305             | -                                       | -                        | -  |                                | 1,305             |
| Issuance of restricted stock units   |                    |                            |                            |                                  | 2,523             | -                                       | (2,523)                  | -  |                                | -                 |
| Amortization of deferred compensation  |                    |                            |                            |                                  | -                 | -                                       | 1,323                    | -  |                                | 1,323             |
| Comprehensive income, net of tax:  |                    |                            |                            |                                  |                   |   |                          |  |                                |                   |
| Net income   |                    |                            |                            |                                  | -                 | -                                       | -                        | 44,519   | \$ 44,519                      | 44,519            |
| Other comprehensive income (loss):   |                    |                            |                            |                                  |                   |   |                          |  |                                |                   |
| Foreign currency translation adjustment  |                    |                            |                            |                                  | -                 | 376                                     | -                        | -  | 376                            | 376               |
| Change in fair value of foreign currency cash flow hedges, net of taxes of \$540                   |                    |                            |                            |                                  | -                 | 933                                     | -                        | -  | 933                            | 933               |
| Net gains on foreign currency cash flow hedges reclassified into earnings, net of taxes of \$538   |                    |                            |                            |                                  | -                 | (943)                                   | -                        | -  | (943)                          | (943)             |
| Total comprehensive income   |                    |                            |                            |                                  |                   |   |                          |  | <u>\$ 44,885</u>               |                   |
| <b>Balance, December 31, 2005</b>  |                    |                            |                            |                                  | <u>477,238</u>    | <u>13,892</u>                           | <u>(4,658)</u>           | <u>256,642</u>                                   |                                | <u>743,114</u>    |
| Issuance of common stock in connection with stock-based compensation plans                         |                    |                            |                            |                                  | 4,513             | -                                       | -                        | -  |                                | 4,513             |
| Reclassification of deferred compensation  |                    |                            |                            |                                  | (4,658)           | -                                       | 4,658                    | -  |                                | -                 |
| Stock-based compensation   |                    |                            |                            |                                  | 7,057             | -                                       | -                        | -  |                                | 7,057             |
| Comprehensive income, net of tax:  |                    |                            |                            |                                  |                   |   |                          |  |                                |                   |
| Net income   |                    |                            |                            |                                  | -                 | -                                       | -                        | 21,034   | \$ 21,034                      | 21,034            |
| Other comprehensive income (loss):   |                    |                            |                            |                                  |                   |   |                          |  |                                |                   |
| Foreign currency translation adjustment  |                    |                            |                            |                                  | -                 | 1,901                                   | -                        | -  | 1,901                          | 1,901             |
| Change in fair value of foreign currency cash flow hedges, net of taxes of \$956                   |                    |                            |                            |                                  | -                 | 1,526                                   | -                        | -  | 1,526                          | 1,526             |
| Net gains on foreign currency cash flow hedges reclassified into earnings, net of taxes of \$1,628 |                    |                            |                            |                                  | -                 | (2,804)                                 | -                        | -  | (2,804)                        | (2,804)           |
| Total comprehensive income   |                    |                            |                            |                                  |                   |   |                          |  | <u>\$ 21,657</u>               |                   |
| <b>Balance, November 15, 2006</b>  |                    |                            |                            |                                  | <u>\$ 484,150</u> | <u>\$ 14,515</u>                        | <u>\$ -</u>              | <u>\$ 277,676</u>                                |                                | <u>\$ 776,341</u> |
| <b>Successor</b>   |                    |                            |                            |                                  |                   |   |                          |  |                                |                   |
| Capitalization of Company  | \$ 12              | \$ 4                       | \$ 16                      | \$ 395,968                       |                   | \$ -                                    | \$ -                     | \$ -   |                                | \$ 396,000        |
| Stock-based compensation   | -                  | -                          | 2                          | 47                               |                   | -                                       | -                        | -  |                                | 49                |
| Comprehensive income, net of tax:  |                    |                            |                            |                                  |                   |   |                          |  |                                |                   |
| Net loss   | -                  | -                          | -                          | -                                |                   | -                                       | -                        | (6,565)  | \$ (6,565)                     | (6,565)           |
| Other comprehensive income (loss):   |                    |                            |                            |                                  |                   |   |                          |  |                                |                   |
| Foreign currency translation adjustment  | -                  | -                          | -                          | -                                |                   | 244                                     | -                        | -  | 244                            | 244               |
| Change in fair value of foreign currency cash flow hedges, net of taxes of \$969                   | -                  | -                          | -                          | -                                |                   | (1,548)                                 | -                        | -  | (1,548)                        | (1,548)           |
| Net losses on foreign currency cash flow hedges reclassified into earnings, net of taxes of \$88   | -                  | -                          | -                          | -                                |                   | 141                                     | -                        | -  | 141                            | 141               |
| Total comprehensive loss   |                    |                            |                            |                                  |                   |   |                          |  | <u>\$ (7,728)</u>              |                   |
| <b>Balance, December 31, 2006</b>  | <u>\$ 12</u>       | <u>\$ 4</u>                | <u>\$ 18</u>               | <u>\$ 396,015</u>                |                   | <u>\$ (1,163)</u>                       | <u>\$ -</u>              | <u>\$ (6,565)</u>                                |                                | <u>\$ 388,321</u> |

**NCO GROUP, INC**  
**Consolidated Statements of Cash Flows**  
(Amounts in thousands)

|  | <u>Successor</u>   | <u>Predecessor</u>   |   |   |
|--|--|--|---|---|
|  | <u>Period from<br/>July 13, 2006<br/>(date of inception)<br/>through<br/>December 31,<br/>2006</u> | <u>Period from<br/>January 1<br/>through<br/>November 15,<br/>2006</u> | <u>Year ended<br/>December 31,<br/>2005</u> | <u>Year ended<br/>December 31,<br/>2004</u> |
| Cash flows from operating activities:  |  |  |   |   |
| Net (loss) income  | \$ (6,565)   | \$ 21,034  | \$ 44,519                                   | \$ 51,863                                   |
| Adjustments to reconcile income from operations<br>to net cash provided by operating activities: |  |  |   |   |
| Depreciation   | 5,697  | 36,403   | 36,352                                      | 32,800                                      |
| Amortization of intangibles  | 5,850  | 10,291   | 9,435                                       | 7,425                                       |
| Stock-based compensation   | 49   | 6,961  | 1,323                                       | 683   |
| Amortization of deferred training asset  | -  | 3,375  | 4,167                                       | 1,918                                       |
| Provision for doubtful accounts  | -  | 3,931  | 3,369                                       | 2,321                                       |
| Allowance and impairment of purchased accounts receivable  | -  | 7,909  | 1,240                                       | 948   |
| Noncash interest   | 3,655  | 5,730  | 7,107                                       | 6,182                                       |
| Gain on sale of purchased accounts receivable  | -  | (22,757)   | (12,157)                                    | -   |
| Loss on disposal of property, equipment and other net assets                                     | -  | 1,153  | 888   | 157   |
| Changes in non-operating income  | 117  | (283)  | (352)                                       | (1,591)                                     |
| Minority interest  | 275  | 6,164  | 2,135                                       | 606   |
| Changes in operating assets and liabilities, net of acquisitions:                                |  |  |   |   |
| Restricted cash  | -  | -  | 900   | 4,950                                       |
| Accounts receivable, trade   | (20,736)   | 16,035   | (18,475)                                    | (2,715)                                     |
| Deferred income taxes  | (3,978)  | 4,483  | 24,917                                      | 28,675                                      |
| Other assets   | 10,523   | (12,693)   | 13,550                                      | (15,827)                                    |
| Accounts payable and accrued expenses  | (308)  | (3,055)  | (9,527)                                     | (9,761)                                     |
| Income taxes payable   | (3,709)  | 27,217   | (19,719)                                    | 545   |
| Other long-term liabilities  | (168)  | (2,226)  | (122)                                       | (10,160)                                    |
| Net cash (used in) provided by operating activities  | <u>(9,298)</u>   | <u>109,672</u>   | <u>89,550</u>                               | <u>99,019</u>                               |
| Cash flows from investing activities:  |  |  |   |   |
| Purchases of accounts receivable - see note 16   | (29,709)   | (81,839)   | (45,743)                                    | (43,549)                                    |
| Collections applied to principal of purchased accounts receivable                                | 13,577   | 70,974   | 69,565                                      | 70,898                                      |
| Proceeds from sales and resales of purchased accounts receivable                                 | 2,801  | 30,551   | 15,880                                      | 15,863                                      |
| Purchases of property and equipment  | (2,246)  | (40,795)   | (43,499)                                    | (27,188)                                    |
| Net distribution from joint venture  | (241)  | (1,597)  | 4,464                                       | 2,083                                       |
| Proceeds from notes receivable   | 82   | 1,033  | 1,147                                       | 1,403                                       |
| Proceeds from disposal of property, equipment and other net assets                               | -  | -  | -   | 1,013                                       |
| Investment in subsidiary by minority interest  | 2,132  | 16,720   | 32,508                                      | -   |
| Net cash paid for acquisitions and related costs   | <u>(974,612)</u>   | <u>(8,590)</u>   | <u>(223,808)</u>                            | <u>(21,981)</u>                             |
| Net cash used in investing activities  | <u>(988,216)</u>   | <u>(13,543)</u>  | <u>(189,486)</u>                            | <u>(1,458)</u>                              |
| Cash flows from financing activities:  |  |  |   |   |
| Repayment of notes payable   | (4,788)  | (53,677)   | (46,754)                                    | (64,814)                                    |
| Borrowings under notes payable   | 5,096  | 17,670   | 36,688                                      | -   |
| Borrowings in connection with the Transaction  | 830,000  | -  | -   | -   |
| Repayment of borrowings under revolving credit agreement   | (229,300)  | (125,700)  | (47,500)                                    | (70,000)                                    |
| Borrowings under revolving credit agreement  | 36,000   | 184,500  | 155,500                                     | -   |
| Repayment of convertible notes   | -  | (125,000)  | -   | -   |
| Payment of fees to acquire debt  | (24,055)   | (12)   | (1,494)                                     | (103)                                       |
| Issuance of stock, net of taxes  | 395,966  | 3,939  | 1,199                                       | 15,375                                      |
| Net cash provided by (used in) financing activities  | <u>1,008,919</u>   | <u>(98,280)</u>  | <u>97,639</u>                               | <u>(119,542)</u>                            |
| Effect of exchange rate on cash  | <u>2,494</u>   | <u>(1,180)</u>   | <u>(321)</u>                                | <u>2,671</u>                                |
| Net increase (decrease) in cash and cash equivalents   | 13,899   | (3,331)  | (2,618)                                     | (19,310)                                    |
| Cash and cash equivalents at beginning of the period   | <u>-</u>   | <u>23,716</u>  | <u>26,334</u>                               | <u>45,644</u>                               |
| Cash and cash equivalents at end of the period   | <u>\$ 13,899</u>   | <u>\$ 20,385</u>   | <u>\$ 23,716</u>                            | <u>\$ 26,334</u>                            |

See accompanying notes.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements**

**1. Nature of Operations and Basis of Presentation:**

On November 15, 2006, NCO Group, Inc. was acquired by and became a wholly owned subsidiary of Collect Holdings, Inc., an entity controlled by One Equity Partners and its affiliates (“OEP”), a private equity investment fund, with participation by Michael J. Barrist, Chairman, President and Chief Executive Officer of NCO Group, Inc., certain other members of executive management and other co-investors (“the Transaction”). Under the terms of the merger agreement, NCO Group, Inc. shareholders received \$27.50 in cash, without interest, for each share of NCO Group, Inc. common stock that they held. The accompanying consolidated financial statements for the Successor period are those of Collect Holdings, Inc., which is referred to as NCO Group, Inc. due to the subsequent merger of NCO Group, Inc. with and into Collect Holdings, Inc. and the change of name to NCO Group, Inc. (collectively with its subsidiaries, “the Company” or “NCO”). The accompanying consolidated balance sheets, statements of operations, stockholders’ equity and cash flows are presented for two periods, Predecessor and Successor, which relate to the period of operations preceding the Transaction and the period of operations succeeding the Transaction, respectively. Collect Holdings, Inc. was formed on July 13, 2006 (there were no operations from date of inception until the Transaction on November 15, 2006).

NCO is a holding company and conducts substantially all of its business operations through its subsidiaries. NCO is a leading provider of business process outsourcing solutions, primarily focused on accounts receivable management (“ARM”) and customer relationship management (“CRM”). NCO provides services to more than 26,000 active clients including many Fortune 500 companies, supporting a broad spectrum of industries, including financial services, telecommunications, healthcare, retail and commercial, utilities, education, transportation/logistics, technology, and government sectors. These clients are primarily located throughout the United States, Canada, the United Kingdom, Europe, Australia, Puerto Rico and Latin America. The Company also purchases and manages past due consumer accounts receivable from consumer creditors such as banks, finance companies, retail merchants, utilities, healthcare companies, and other consumer-oriented companies.

The Company’s business consists of three operating divisions: ARM, CRM and Portfolio Management.

**2. Accounting Policies:**

*Principles of Consolidation:*

The consolidated financial statements include the accounts of the Company and all affiliated subsidiaries and entities controlled by the Company. All intercompany accounts and transactions have been eliminated.

At December 31, 2006, the Company had a \$7.9 million note receivable included in the balance sheet under current and long-term other assets from an entity that was previously owned by the Company. Under FASB Interpretation No. 46(R), “Consolidation of Variable Interest Entities” (“FIN 46(R)”), the entity that issued this note receivable is considered a variable interest entity. Based on its evaluation of this variable interest entity, the Company is not the primary beneficiary of this entity; therefore, the Company has not consolidated this entity under FIN 46(R).

*Revenue Recognition:*

ARM Contingency Fees:

ARM contingency fee revenue is recognized upon physical receipt of funds by NCO or its client.

ARM Contractual Services:

Fees for ARM contractual services are recognized as services are performed and earned under service arrangements with clients where fees are fixed or determinable and collectibility is reasonably assured.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**2. Accounting Policies (continued):**

*Revenue Recognition (continued):*

CRM Hourly:

Revenue is recognized based on the billable hours of each CRM representative as defined in the client contract. The rate per billable hour charged is based on a predetermined contractual rate, as agreed in the underlying contract. The contractual rate can fluctuate based on certain pre-determined objective performance criteria related to quality and performance, reduced by any contractual performance penalties the client may be entitled to, both as measured on a monthly basis. The impact of the performance criteria and penalties on the rate per billable hour is continually updated as revenue is recognized.

CRM Performance Based:

Under performance-based arrangements, the Company is paid by its customers based on achievement of certain levels of sales or other client-determined criteria specified in the client contract. The Company recognizes performance-based revenue by measuring its actual results against the performance criteria specified in the contracts.

Training Revenue:

In connection with the provisions of certain inbound and outbound CRM services, the Company incurs costs to train its CRM representatives. Training programs relate to both program start-up training in connection with new CRM programs (“Start-up Training”) and on-going training for updates of existing CRM programs (“On-going Training”). The Company bills some of its customers for the costs incurred under these training programs based on the terms in the contract. Training revenue is integral to the CRM revenue being generated over the course of a contract and cannot be separated as a discrete earnings process under SEC Staff Accounting Bulletin No. 104. Start-up Training and On-going Training revenues are initially deferred and recognized over the shorter of the term of the customer contract, or the period to be benefited. Direct costs associated with providing Start-up Training and On-going Training, which consist of salary, benefit and travel costs, are also deferred and amortized over a time period consistent with the deferred training revenue. When a business relationship is terminated with one of the Company’s customers, the unamortized deferred training revenue and unamortized deferred direct costs associated with that customer are immediately recognized. At December 31, 2006, the balance of deferred training revenue was \$735,000 and deferred costs capitalized were \$619,000.

Purchased Accounts Receivable:

The Company applies American Institute of Certified Public Accountants (“AICPA”) Statement of Position 03-3, “Accounting for Loans or Certain Securities Acquired in a Transfer” (“SOP 03-3”). SOP 03-3 addresses accounting for differences between contractual versus expected cash flows over an investor’s initial investment in certain loans when such differences are attributable, at least in part, to credit quality.

The Company has maintained historical collection records for all of its purchased accounts receivable, as well as debtor records since its entrance into this business and for acquired businesses since 1986, which provides a reasonable basis for the Company’s judgment that it is probable that it will ultimately collect the recorded amount of its purchased accounts receivable plus a premium or yield. The historical collection amounts also provide a reasonable basis for determining the timing of the collections. The Company uses all available information to forecast the cash flows of its purchased accounts receivable including, but not limited to, historical collections, payment patterns on similar purchases, credit scores of the underlying debtors, seller’s credit policies, and location of the debtor.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**2. Accounting Policies (continued):**

*Revenue Recognition (continued):*

Purchased Accounts Receivable (continued):

The Company acquires accounts receivable in groups or portfolios that are initially recorded at cost, which includes external costs of acquiring portfolios. Once a portfolio is acquired, the accounts in the portfolio are not changed, unless replaced, returned, or sold. All acquired accounts receivable have experienced deterioration of credit quality between origination and the Company's acquisition of the accounts receivable, and the amount paid for a portfolio of accounts receivable reflects the Company's determination that it is probable the Company will be unable to collect all amounts due according to each loan's contractual terms. As such, the Company determines whether each portfolio of accounts receivable is to be accounted for individually or whether such accounts receivable will be aggregated based on common risk characteristics. The Company considers expected collections, and estimates the amount and timing of undiscounted expected principal, interest, and other cash flows (expected at acquisition) for each portfolio of accounts receivable and subsequently aggregated pools of accounts receivable. The Company determines nonaccretable difference, or the excess of the portfolio's contractual principal over all cash flows expected at acquisition as an amount that should not be accreted. The remaining amount represents accretable yield, or the excess of the portfolio's cash flows expected to be collected over the amount paid, and is accreted into earnings over the remaining life of the portfolio.

At acquisition, the Company derives an internal rate of return ("IRR") based on the expected monthly collections over the estimated economic life of each portfolio of loans (typically up to seven years, based on the Company's collection experience) compared to the original purchase price. Collections on the portfolios are allocated to revenue and principal reduction based on the estimated IRR for each portfolio of accounts receivable. Revenue on purchased accounts receivable is recorded monthly based on applying each portfolio's effective IRR for the quarter to its carrying value. Over the life of a portfolio, the Company continues to estimate cash flows expected to be collected. The Company evaluates at the balance sheet date whether the present value of its portfolios determined using the effective interest rates has decreased, and if so, records an expense to establish a valuation allowance to maintain the original IRR established at acquisition. Any increase in actual or estimated cash flows expected to be collected is first used to reverse any existing valuation allowance for that portfolio, or aggregation of portfolios, and any remaining increases in cash flows are recognized prospectively through an increase in the IRR. The updated IRR then becomes the new benchmark for subsequent valuation allowance testing.

Portfolio Sales:

The Company accounts for proceeds from sales of aged portfolios of purchased accounts receivable above the remaining carrying value under SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." Revenue from these sales is recognized when the receivables are sold.

The Company applies a financial components approach. Generally, that approach focuses on control of each of the various retained or sold interests or liabilities in a given financial asset sale to conclude when a sale has actually occurred as compared to a mere financing, and the accounting for any related rights retained and/or duties committed to on an ongoing basis, including servicing. Under that approach, after a transfer of financial assets, an entity allocates a portion of its original cost of the assets to the assets sold in determining any gain or loss, and to any servicing assets it retains, such as servicing rights or rights to residual interests. Gain or loss is reported in the period of the transfer, and net of any liabilities it has incurred or will incur in the future. Assets retained are amortized over the appropriate useful life of the asset. If control has not been adequately transferred to the other party, the proceeds received are treated as financing and no gain or loss is recorded at the time of the transfer.

Management monitors its client relationships in order to minimize the Company's credit risk and assesses the likelihood of collection based on a number of factors including the client's collection history and credit-worthiness. The Company maintains a reserve for potential collection losses when such losses are deemed to be probable.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**2. Accounting Policies (continued):**

*Credit Policy:*

The Company has two types of arrangements under which it collects its ARM contingency fee revenue. For certain clients, the Company remits funds collected on behalf of the client net of the related contingency fees while, for other clients, the Company remits gross funds collected on behalf of clients and bills the client separately for its contingency fees.

The Company generally does not require collateral and it does not charge finance fees on outstanding trade receivables. In many cases, in the event of collection delays from ARM clients, management may, at its discretion, change from the gross remittance method to the net remittance method. The Company also maintains a reserve for deposits on debtor accounts that may ultimately prove to have insufficient funds. Trade accounts receivable are written off to the allowances when collection appears highly unlikely.

*Cash and Cash Equivalents:*

The Company considers all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents. These financial instruments potentially subject the Company to concentrations of credit risk. The Company minimizes this risk by dealing with major financial institutions that have high credit ratings.

*Property and Equipment:*

Property and equipment is stated at cost, less accumulated depreciation. Depreciation is provided over the estimated useful life of each class of assets using the straight-line method. Expenditures for maintenance and repairs are charged to expense as incurred. Renewals and betterments are capitalized. When property is sold or retired, the cost and related accumulated depreciation are removed from the balance sheet, and any gain or loss on the transaction is included in the statement of operations.

*Long-Lived Assets:*

The Company periodically evaluates the net realizable value of long-lived assets, including property and equipment, internal use software, and certain identifiable intangible assets, for impairment, based on the estimated undiscounted future cash flows, whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

*Goodwill:*

Goodwill represents the excess of purchase price over the fair market value of net assets acquired, based on their respective fair values at the date of acquisition. Goodwill is tested for impairment each year on October 1, and as triggering events occur. The goodwill impairment test is performed at the reporting unit level and involves a two-step approach: the first step identifies any potential impairment and the second step measures the amount of impairment, if applicable. The first test for potential impairment uses a fair-value based approach, whereby the implied fair value of a reporting unit's goodwill is compared to its carrying amount; if the fair value is less than the carrying amount, the reporting unit's goodwill would be considered impaired. Fair value estimates are based upon the discounted value of estimated cash flows. Since the Transaction occurred on November 15, 2006, the Company used the valuations performed in connection with the Transaction to identify any potential impairment for 2006. The Company has concluded that goodwill was not impaired as of December 31, 2006.

*Trade Name:*

Trade name, which represents the fair value of the NCO name, is an indefinite-lived intangible asset and therefore not subject to amortization. Similar to goodwill, the trade name will be reviewed at least annually for impairment (note 8).

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**2. Accounting Policies (continued):**

*Customer Relationships and Other Intangible Assets:*

Other intangible assets consist primarily of customer relationships and non-compete agreements, which are amortized over a range of six to seven years using the straight-line method (note 8).

*Deferred Financing Fees:*

Deferred financing fees relate to debt issuance costs incurred, which are capitalized and amortized to interest expense on a straight-line basis over the term of the related debt.

*Stock Options:*

Effective January 1, 2006, the Company adopted FASB Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which is a revision of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," and supercedes APB Opinion 25, "Accounting for Stock Issued to Employees" ("APB 25"). SFAS 123R requires that the cost of all share-based payments to employees, including stock option grants, be recognized in the financial statements over the vesting period based on their fair values. The standard applies to newly granted awards and previously granted awards that are not fully vested on the date of adoption. The Company adopted SFAS 123R using the modified prospective method, which requires that compensation expense be recorded for all unvested stock options at the beginning of the first quarter of adoption of SFAS 123R. Accordingly, no prior periods have been restated.

As a result of adopting SFAS 123R on January 1, 2006, the Company's income before income taxes and net income for the period from January 1, 2006 through November 15, 2006 were \$2.1 million and \$1.2 million lower, respectively, than if it had continued to account for share based compensation under APB 25. Also, in connection with the adoption of SFAS 123R, the unearned stock-based compensation balance of \$4.7 million was reclassified to common stock as of January 1, 2006.

On November 15, 2006, in connection with the Transaction and in accordance with the terms of the equity awards, the vesting of all outstanding unvested options to purchase the Company's stock and restricted stock units was accelerated, and the Company recorded compensation expense of approximately \$5.1 million for the acceleration.

Prior to January 1, 2006, the Company accounted for stock option grants in accordance with APB 25 and related interpretations. Under APB 25, because the exercise price of the stock options equaled the fair value of the underlying common stock on the date of grant, no compensation cost was recognized. In accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," the Company did not recognize compensation cost based on the fair value of the options granted at grant date. If the Company had elected to recognize compensation cost based on the fair value of the options granted at grant date, net income and net income per share would have been reduced to the pro forma amounts indicated in the following table (amounts in thousands, except per share amounts) (note 13):

|   | Predecessor         |           |
|---|---------------------|-----------|
|   | For the Years Ended |           |
|   | December 31,        |           |
|   | 2005                | 2004      |
| Net income – as reported                  | \$ 44,519           | \$ 51,863 |
| Pro forma compensation cost, net of taxes | 6,631               | 3,292     |
| Net income – pro forma                    | \$ 37,888           | \$ 48,571 |

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**2. Accounting Policies (continued):**

*Stock Options (continued):*

Effective December 29, 2005, the Company accelerated the vesting of outstanding unvested options to purchase the Company's common stock, which had an exercise price equal to or greater than \$17.25 per share ("Eligible Options"). Any shares received upon the exercise of Eligible Options were restricted and not to be sold prior to the date on which the Eligible Options would have been exercisable under the original terms. As a result of the acceleration, options to purchase 944,308 shares of the Company's common stock became immediately exercisable. All other terms and conditions applicable to the Eligible Options remained unchanged. All terms and conditions of all options that are not Eligible Options remained unchanged. The purpose of the acceleration of the Eligible Options was to eliminate future compensation expense that would have otherwise been recognized upon the Company's adoption of SFAS 123R on January 1, 2006 (note 21). The proforma compensation cost, net of taxes, for 2005 in the table above includes \$3.9 million for the effect of this acceleration.

Compensation expense recognized related to stock option awards for the period from January 1, 2006 through November 15, 2006 was \$2.1 million, including \$1.5 million for the acceleration of vesting in connection with the Transaction. During the period from January 1, 2006 through November 15, 2006, compensation expense of \$5.0 million was recorded for restricted stock units, including \$3.6 million for the acceleration of vesting in connection with the Transaction. During the years ended December 31, 2005 and 2004, compensation expense of \$1.3 million and \$683,000 was recorded for restricted stock units, respectively. Compensation expense recorded equaled the fair value of the shares vested during the respective period.

*Income Taxes:*

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes" ("SFAS 109") which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized. Deferred taxes have not been provided on the cumulative undistributed earnings of foreign subsidiaries because such amounts are expected to be reinvested indefinitely.

*Foreign Currency Translation:*

The Company has foreign subsidiaries whose local currency has been determined to be the functional currency for that subsidiary. The assets and liabilities of these foreign subsidiaries have been translated using the current exchange rates, and the income and expenses have been translated using average historical exchange rates. The adjustments resulting from translation have been recorded separately in stockholders' equity as "Other comprehensive income (loss)" and are not included in determining consolidated net income. As of December 31, 2006 and 2005, "Other comprehensive income (loss)" included \$244,000 and \$13.6 million, respectively, of cumulative income from foreign currency translation.

*Use of Estimates:*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**2. Accounting Policies (continued):**

*Use of Estimates (continued):*

The application of SFAS No. 141, "Business Combinations" requires the measurement of fair values of purchased assets and liabilities of an acquired entity. In connection with the Transaction and other purchase business combinations, management makes additional estimates and assumptions in determining fair value that affect amounts reported in the financial statements and accompanying notes. The more significant financial statement items include intangible assets, purchased accounts receivable, and nonrecourse debt.

In the ordinary course of accounting for purchased accounts receivable, estimates are made by management as to the amount and timing of future cash flows expected from each portfolio. The estimated future cash flow of each portfolio is used to compute the IRR for the portfolio, both in the case of any increases in expected cash flows, or to compute impairment or allowances in the case of decreases in expected cash flows. The IRR is used to allocate collections between revenue and principal reduction of the carrying values of the purchased accounts receivable.

On an ongoing basis, the Company compares the historical trends of each portfolio to projected collections. Future projected collections are then increased or decreased based on the actual cumulative performance of each portfolio. Management reviews each portfolio's adjusted projected collections to determine if further upward or downward adjustment is warranted. Management regularly reviews the trends in collection patterns and uses its reasonable best efforts to improve the collections of underperforming portfolios. However, actual results will differ from these estimates and a material change in these estimates could occur within one reporting period (note 5).

*Derivative Financial Instruments:*

The Company selectively uses derivative financial instruments to manage interest costs and minimize currency exchange risk. The Company does not hold derivatives for trading purposes. While these derivative financial instruments are subject to fluctuations in value, these fluctuations are generally offset by the value of the underlying exposures being hedged. The Company minimizes the risk of credit loss by entering into these agreements with major financial institutions that have high credit ratings. The Company accounts for its derivative financial instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") which requires companies to recognize all of their derivative instruments as either assets or liabilities in the balance sheet at fair value.

The Company is exposed to foreign currency fluctuations relating to its operations in foreign countries. In order to partially hedge cash flow exposure, the Company periodically enters into forward exchange contracts in order to minimize the impact of currency fluctuations on transactions and cash flows. These contracts are designated as cash flow hedges and recorded at their fair value on the accompanying balance sheets. Changes in the fair value of a cash flow hedge, to the extent that the hedge is effective, are recorded, net of tax, in "Other comprehensive income (loss)," until earnings are affected by the variability of the hedged cash flows. Cash flow hedge ineffectiveness, defined as the extent that the changes in fair value of the derivative exceed the variability of cash flows of the forecasted transaction, is recorded currently in the statement of operations (note 14).

The Company is exposed to interest rate fluctuations relating to its long-term debt. To manage this interest rate risk, the Company enters into interest rate caps. These contracts are not cash flow hedges and, accordingly, changes in their estimated fair value are reported as "Other income (expense)" in the statement of operations.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**2. Accounting Policies (continued):**

*Derivative Financial Instruments (continued):*

The Company has certain nonrecourse debt relating to its purchased accounts receivable operations that contain embedded derivative instruments. The embedded derivatives are not cash flow hedges and, accordingly, changes in their estimated fair value are reported as “Other income (expense)” in the statement of operations. The embedded derivatives are included in “Long-term debt” on the balance sheet because they are not separable from the notes payable and they have the same counterparty (note 10).

*Reclassifications:*

Certain amounts have been reclassified for comparative purposes.

**3. Predecessor Restructuring Charges:**

In conjunction with the integration of Risk Management Alternatives Parent Corp. (“RMA”) (note 4) and streamlining the cost structure of the Company’s legacy operations, the Company recorded total restructuring charges of \$22.4 million during the end of 2005 through November 15, 2006. These charges primarily related to the elimination of certain redundant facilities and severance costs.

The following presents the activity in the accruals recorded for restructuring charges (amounts in thousands):

|                                 | <u>Leases</u>          | <u>Severance</u>     | <u>Total</u>           |
|---------------------------------|------------------------|----------------------|------------------------|
| Balance at January 1, 2005      | \$ -                   | \$ -                 | \$ -                   |
| Accruals                        | 7,020                  | 2,601                | 9,621                  |
| Cash payments                   | (790)                  | (1,010)              | (1,800)                |
| Leasehold improvement write-off | (1,905)                | -                    | (1,905)                |
| Balance at December 31, 2005    | <u>\$ 4,325</u>        | <u>\$ 1,591</u>      | <u>\$ 5,916</u>        |
| Accruals                        | 11,145                 | 1,620                | 12,765                 |
| Cash payments                   | (7,199)                | (2,262)              | (9,461)                |
| Leasehold improvement write-off | (993)                  | -                    | (993)                  |
| Balance at November 15, 2006    | <u><u>\$ 7,278</u></u> | <u><u>\$ 949</u></u> | <u><u>\$ 8,227</u></u> |

**4. Business Combinations:**

*Successor:*

As discussed in note 1, the Transaction was completed on November 15, 2006. The Transaction was financed by a combination of borrowings of \$465.0 million under the Company’s new senior credit facility (“Credit Facility”), the issuance of \$165.0 million of senior notes and \$200.0 million of senior subordinated notes, and the equity investment of \$396.0 by OEP, Michael Barrist, other members of senior management and other co-investors. In accordance with Emerging Issues Task Force Issue No. 88-16, “Basis in Leveraged Transactions” (“EITF 88-16”), the continuing stockholders’ residual interest in the Company of 5.56 percent was carried over at the continuing stockholders’ predecessor basis.

The purchase price, including transaction costs, was approximately \$1.2 billion. Transaction costs included approximately \$22.8 million of debt issuance costs. The Company allocated \$312.9 million of the purchase price to the customer relationship, \$96.6 million to the trade name, \$2.2 million to the non-compete agreements and recorded goodwill of \$583.3 million, which is non-deductible for tax purposes, based on preliminary estimates. As a result of the Transaction, the Company expects to gain greater operating flexibility in order to focus on long-term growth. Therefore the Company believes the preliminary allocation of a portion of the purchase price to goodwill is appropriate.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**4. Business Combinations (continued):**

*Successor (continued):*

The following is a preliminary allocation of the purchase price to the assets acquired and liabilities assumed (amounts in thousands):

|  |                   |
|--|-------------------|
| Purchase price                         | \$ 1,153,233      |
| Transaction costs                      | 68,498            |
| Accounts receivable                    | (123,023)         |
| Purchased accounts receivable          | (230,399)         |
| Customer relationships                 | (312,885)         |
| Trade name                             | (96,613)          |
| Non-compete agreements                 | (2,172)           |
| Property and equipment                 | (134,240)         |
| Deferred tax asset                     | (28,208)          |
| Other assets                           | (106,633)         |
| Long-term debt                         | 48,350            |
| Deferred tax liability                 | 161,350           |
| Accrued expenses and other liabilities | 178,351           |
| Accrued acquisition costs              | <u>7,727</u>      |
| Goodwill                               | <u>\$ 583,336</u> |

In connection with the Transaction, the Company recorded restructuring liabilities of \$7.7 million under an exit plan the Company began to formulate prior to the Transaction date. These liabilities principally relate to facilities leases, severance and other costs. The following presents the activity in the accruals recorded for restructuring related expenses (amounts in thousands):

|                              | <u>Leases</u>   | <u>Severance</u> | <u>Other</u> | <u>Total</u>    |
|------------------------------|-----------------|------------------|--------------|-----------------|
| Beginning Balance            | \$ 5,025        | \$ 2,374         | \$ 328       | \$ 7,727        |
| Cash payments                | -               | (79)             | (328)        | (407)           |
| Balance at December 31, 2006 | <u>\$ 5,025</u> | <u>\$ 2,295</u>  | <u>\$ -</u>  | <u>\$ 7,320</u> |

On December 18, 2006, the Company acquired the assets of Star Contact (BVI) Ltd. and Call Center-Telemarketing Pro-Panama, S.A. (together "Star Contact"), a provider of outsourced, multi-lingual contact center and customer care services based in Panama City, Panama, for \$36.0 million. The acquisition agreement contains a provision for annual earnout payments to be made to the seller, for each of the two years following the acquisition, provided that certain performance measures are met as of the end of each of the two years. The Company allocated \$11.7 million of the purchase price to the customer relationships and recorded goodwill of \$17.2 million, which is non-deductible for tax purposes, in the CRM segment. As a result of the acquisition, the Company expects to penetrate new markets, expand its current customer base, and reduce the cost of operations.

The following is a preliminary allocation of the purchase price to the assets acquired and liabilities assumed (amounts in thousands):

|                        |                  |
|------------------------|------------------|
| Purchase price         | \$ 36,000        |
| Customer relationships | (11,694)         |
| Property and equipment | (5,688)          |
| Other assets           | (5,260)          |
| Accrued expenses       | <u>3,852</u>     |
| Goodwill               | <u>\$ 17,210</u> |

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**4. Business Combinations (continued):**

*Predecessor:*

The following Predecessor acquisitions have been accounted for under the purchase method of accounting. As part of the purchase accounting, the Company recorded accruals for acquisition-related expenses. These accruals included professional fees related to the acquisition, severance costs, lease costs and other acquisition-related expenses.

On April 2, 2004, the Company completed the acquisition of RMH Teleservices, Inc. (“RMH”) a provider of CRM services. In connection with the RMH acquisition, the Company originally recorded restructuring liabilities of \$36.9 million under an exit plan the Company began to formulate prior to the acquisition date. The Company made payments of \$2.1 million for the period from January 1, 2006 through November 15, 2006, and \$79,000 for the period from July 13, 2006 through December 31, 2006. In addition, in connection with purchase accounting for the Transaction, the Company adjusted the fair market value of certain RMH restructuring liabilities, which resulted in a downward adjustment of \$744,000. The balance of liabilities outstanding at December 31, 2006 was \$3.9 million. The Company expects to pay the remaining balance through 2012.

On May 25, 2005, the Company acquired Creative Marketing Strategies (“CMS”), a provider of CRM services, for \$5.9 million. The purchase price included the contribution of a note receivable for \$5.2 million that the Company received in 2000 in consideration for assets sold to a management-led group as part of a divestiture.

On September 1, 2005, the Company acquired the stock of seven wholly owned subsidiaries of Marlin Integrated Capital Holding Corporation (“Marlin”), a company that specializes in purchasing accounts receivable in the healthcare and utility sectors, for \$89.9 million in two transactions. The first transaction included the acquisition of a portfolio of purchased accounts receivable for \$66.3 million. The second transaction included the acquisition of certain portfolio related assets for approximately \$22.1 million. A \$3.0 million payment was deferred pending the renewal of certain forward-flow agreements. One renewal occurred in December 2005, resulting in an additional payment of \$1.5 million. The second renewal was completed in the first quarter of 2006, resulting in a final payment of \$1.5 million.

The acquisition of the purchased accounts receivable portfolio was structured as an equity sharing arrangement with the Company’s nonrecourse lender under the Company’s nonrecourse credit facility. The lender originally invested \$32.0 million in the acquisition, representing a 50 percent interest in the purchased accounts receivable portfolio assets. The Company granted an option to the lender to purchase up to 50 percent of the other non-portfolio assets and liabilities acquired from Marlin. The option was exercised and the transaction was completed in the first quarter of 2006. The Company received \$12.7 million for the 50 percent interest in the non-portfolio assets and liabilities. The Company funded its 50 percent portion of the acquisition of the portfolio assets and the acquisition of all of the operating assets with financing from its senior credit facility. By design, the Company controls the primary activities of the entity and as such has recorded a minority interest on its balance sheet for the lender’s equity interest. The Company has consolidated the results of operations and recorded the portion of the results of the Marlin acquisition it does not own as a minority interest, net of tax, on the statement of operations.

Prior to the acquisition, Portfolio Management had a 50 percent ownership interest in a joint venture, InoVision-MEDCLR NCOP Ventures, LLC (“the Joint Venture”) with IMNV Holdings, LLC (“IMNV”), one of the acquired subsidiaries of Marlin. The Joint Venture was established in 2001 to purchase utility, medical and various other small balance accounts receivable. In connection with the acquisition, the Joint Venture was terminated and the Company’s interest was included in the purchase accounting for the entity.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**4. Business Combinations (continued):**

*Predecessor (continued):*

On September 12, 2005, the Company acquired substantially all of the operating assets, including purchased portfolio assets, of RMA, a provider of accounts receivable management services and purchaser of accounts receivable, for \$116.1 million in cash and the assumption of certain liabilities. The Company funded the purchase principally with financing from its senior credit facility. The purchase price included approximately \$51.0 million for RMA's purchased portfolio assets, which was funded with \$35.7 million of nonrecourse financing. In conjunction with the acquisition, on July 7, 2005, RMA and all of its domestic subsidiaries filed for protection under Chapter 11 of the Bankruptcy Code with the U.S. Bankruptcy Court for the Northern District of Ohio Eastern Division. The transaction was consummated under Sections 363 and 365 of the bankruptcy code. In connection with the acquisition, the Company recorded restructuring liabilities of \$8.7 million under an exit plan the Company began to formulate prior to the acquisition date. These liabilities principally relate to severance costs related to certain redundant personnel that were scheduled to be eliminated upon completion of the acquisition.

The following presents the activity in the accruals recorded for RMA acquisition related expenses (amounts in thousands):

|                               | <u>Severance</u> | <u>Leases</u> | <u>Other</u> | <u>Total</u>   |
|-------------------------------|------------------|---------------|--------------|----------------|
| Balance at September 12, 2005 | \$ 9,476         | \$ 500        | \$ 3         | \$ 9,979       |
| Cash payments                 | (5,243)          | (503)         | (3)          | (5,749)        |
| Accrual adjustments           | <u>(1,245)</u>   | <u>3</u>      | <u>10</u>    | <u>(1,232)</u> |
| Balance at January 1, 2006    | \$ 2,988         | \$ -          | \$ 10        | \$ 2,998       |
| Cash payments                 | (2,242)          | -             | (2)          | (2,244)        |
| Accrual adjustments           | <u>(740)</u>     | <u>-</u>      | <u>(8)</u>   | <u>(748)</u>   |
| Balance at November 15, 2006  | <u>\$ 6</u>      | <u>\$ -</u>   | <u>\$ -</u>  | <u>\$ 6</u>    |

On July 1, 2006, the Company acquired a seventy-five percent controlling interest in Australian Receivables Limited ("ARL"), a provider of ARM services in Australia, for \$3.3 million.

*Pro forma:*

The following summarizes the unaudited pro forma results of operations, assuming the Transaction and the RMA acquisition described above occurred as of the beginning of the respective periods. The pro forma information presented does not include the other acquisitions because they were not considered significant business combinations. The unaudited pro forma information is provided for informational purposes only. It is based on historical information, and does not necessarily reflect the actual results that would have occurred, nor is it indicative of future results of operations of the consolidated entities (amounts in thousands, except per share data):

|          | <u>For the Years Ended</u> |              |
|----------|----------------------------|--------------|
|          | <u>December 31,</u>        |              |
|          | <u>2006</u>                | <u>2005</u>  |
| Revenue  | \$ 1,169,813               | \$ 1,181,805 |
| Net loss | \$ (57,401)                | \$ (91,762)  |

**5. Purchased Accounts Receivable:**

Portfolio Management and the Canadian, U.K. and Australian divisions of ARM purchase defaulted consumer accounts receivable at a discount from the contractual principal balance. As of December 31, 2006, the carrying value of Portfolio Management's and ARM's purchased accounts receivable were \$239.1 million and \$5.0 million, respectively. The total outstanding balance due, representing the original undiscounted contractual amount less collections since acquisition, was \$41.8 billion and \$37.1 billion at December 31, 2006 and 2005, respectively.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**5. Purchased Accounts Receivable (continued):**

The following summarizes the change in purchased accounts receivable (amounts in thousands):

|   | Successor   | Predecessor   |   |                   |
|---|---|---|---|-------------------|
|   | Period from<br>July 13<br>through<br>December 31,<br>2006 | Period from<br>January 1<br>through<br>November 15,<br>2006 | For the Years Ended<br>December 31,<br>2005      2004 |                   |
| Balance at beginning of period                                      | \$ -  | \$ 237,807  | \$ 138,857  | \$ 152,613        |
| Purchases:  |   |   |   |                   |
| Portfolios acquired in business combinations                        | 230,399   | -   | 117,230   | -                 |
| Cash purchases  | 29,709  | 81,839  | 45,743  | 46,837            |
| Noncash purchases (note 16)   | -   | 1,025   | 17,213  | 42,832            |
| Collections   | (26,850)  | (220,586)   | (200,703)   | (169,167)         |
| Revenue recognized  | 13,273  | 149,612   | 131,138   | 98,269            |
| Proceeds from portfolio sales and resales applied to carrying value | (2,801)   | (7,794)   | (3,723)   | (15,863)          |
| Allowance and impairment  | -   | (7,909)   | (1,240)   | (948)             |
| Dissolution of securitization                                       | -   | -   | (6,399)   | (13,673)          |
| Fair value purchase accounting adjustment                           | -   | -   | -   | (2,324)           |
| Foreign currency translation adjustment                             | 370   | 413   | (309)   | 281               |
| Balance at end of period  | <u>\$ 244,100</u>   | <u>\$ 234,407</u>   | <u>\$ 237,807</u>                                     | <u>\$ 138,857</u> |

In the ordinary course of purchasing portfolios of accounts receivable, Portfolio Management may sell accounts from an acquired portfolio shortly after they were purchased. The proceeds from these resales are essentially equal to, and applied against, the carrying value of the accounts. Therefore, there is no gain recorded on these resales. Proceeds from portfolio resales were \$6.7 million for the period from January 1, 2006 through November 15, 2006, and \$1.4 million for the period from July 13, 2006 through December 31, 2006. For the years ended December 31, 2005 and 2004, proceeds from portfolio resales were \$2.4 million and \$10.7 million, respectively.

In 2005, Portfolio Management began an on-going process to identify and sell certain aged and bankruptcy status portfolios of accounts receivable that have a low probability of payment under the Company's collection platform. These portfolios have a low remaining carrying value. Proceeds from sales above the remaining carrying value are recorded as revenue. Portfolio Management sold portfolios of accounts receivable for \$25.6 million with a carrying value of \$2.8 million, and recorded revenue of \$22.8 million for the period from January 1, 2006 through November 15, 2006. For the period from July 13, 2006 through December 31, 2006, sales of accounts receivable resulted in proceeds of \$1.4 million with no associated revenue recorded since these assets were carried at their fair market value as of the date of the Transaction. During the year ended December 31, 2005, Portfolio Management sold portfolios of accounts receivable for \$13.4 million with a carrying value of \$1.3 million, and recorded revenue of \$12.2 million.

In 2005, the Company received \$1.9 million of proceeds from the dissolution, winding up and sale of a securitization established in August 1998. The finance subsidiary holding the receivables adopted a plan of liquidation and proceeded to liquidate the receivables on behalf of and in cooperation with the securitized note insurer. The notes matured in March 2005, at which time the notes were paid off by the note insurer and the insurer became the holder of the obligations. The securitized notes and note insurer obligations were nonrecourse to the Company. The proceeds of the sale were used to reduce the carrying value of the accounts receivable and pay down the related insurer obligations. The net effect on earnings of the winding up of the dissolution of the finance subsidiary was immaterial (note 10).

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**5. Purchased Accounts Receivable (continued):**

In 2004, the Company received \$5.2 million of proceeds from the dissolution, winding up and sale of a securitization established in August 1999. The finance subsidiary holding the receivables adopted a plan of liquidation and proceeded to liquidate the receivables on behalf of and in cooperation with the securitized note holders prior to the December 31, 2004 maturity date of the notes. The securitized notes were nonrecourse to the Company. The proceeds of the sale were used to reduce the carrying value of the accounts receivable and pay down the related securitized note. The net effect on earnings of the winding up of the dissolution of the finance subsidiary was immaterial.

The following presents the change in the allowance for impairment of purchased accounts receivable accounted for under SOP 03-3 (amounts in thousands):

|  | Successor   | Predecessor   |   |
|--|---|---|---|
|  | Period from<br>July 13<br>through<br>December 31,<br>2006 | Period from<br>January 1<br>through<br>November 15,<br>2006 | For the Year<br>Ended<br>December 31,<br>2005 |
| Balance at beginning of period             | \$ -  | \$ 1,192  | \$ -  |
| Additions                                  | -   | 8,492   | 1,598   |
| Recoveries                                 | -   | (598)   | (406)   |
| Foreign currency translation<br>adjustment |   | 15  |   |
| Balance at end of period                   | <u>\$ -</u>   | <u>\$ 9,101</u>   | <u>\$ 1,192</u>                               |

Accretable yield represents the excess of the cash flows expected to be collected during the life of the portfolio over the initial investment in the portfolio. The following presents the change in accretable yield (amounts in thousands):

|  | Successor   | Predecessor   |                                     |                   |
|--|---|---|-------------------------------------|-------------------|
|  | Period from<br>July 13<br>through<br>December 31,<br>2006 | Period from<br>January 1<br>through<br>November 15,<br>2006 | For the Years Ended<br>December 31, |                   |
|  |   |   | 2005                                | 2004              |
| Balance at beginning of period                     | \$ -  | \$ 288,935  | \$ 160,083                          | \$ 144,727        |
| Additions  | 478,724   | 106,145   | 216,201                             | 105,644           |
| Accretion  | (13,273)  | (149,612)   | (131,138)                           | (98,269)          |
| Reclassifications from<br>nonaccretable difference | -   | 16,953  | 44,058                              | 7,941             |
| Foreign currency translation<br>adjustment         | -   | 261   | (269)                               | 40                |
| Balance at end of period                           | <u>\$ 465,451</u>   | <u>\$ 262,682</u>   | <u>\$ 288,935</u>                   | <u>\$ 160,083</u> |

The Company purchased accounts receivable for a cost of \$81.8 million and \$260.1 million, that had contractually required payments receivable at the date of acquisition of \$3.1 billion and \$41.8 billion, and expected cash flows at the date of acquisition of \$187.6 million and \$736.4 million, for the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, respectively. During the years ended December 31, 2005 and 2004, the Company purchased accounts receivable for a cost of \$180.2 million and \$89.7 million, respectively, including portfolios acquired through business combinations, that had contractually required payments receivable at the date of acquisition of \$22.6 billion and \$2.7 billion, respectively, and expected cash flows at the date of acquisition of \$396.4 million and \$195.3 million, respectively.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**6. Funds Held on Behalf of Clients:**

In the course of the Company's subsidiaries' regular business activities as a provider of accounts receivable management services, the Company receives clients' funds arising from the collection of accounts placed with the Company. These funds are placed in segregated cash accounts and are generally remitted to clients within 30 days. Funds held on behalf of clients of \$60.2 million and \$52.3 million at December 31, 2006 and 2005, respectively, have been shown net of their offsetting liability for financial statement presentation.

**7. Property and Equipment:**

Property and equipment, at cost, consisted of the following (amounts in thousands):

|   | Estimated<br>Useful Life | Successor<br>December 31,<br>2006 | Predecessor<br>December 31,<br>2005 |
|---|--------------------------|-----------------------------------|-------------------------------------|
| Computer equipment                              | 5 years                  | \$ 58,660                         | \$ 151,514                          |
| Computer software developed<br>for internal use | 5 years                  | 38,284                            | 68,154                              |
| Furniture and fixtures                          | 5 to 10 years            | 15,510                            | 32,168                              |
| Leasehold improvements                          | 5 to 15 years            | 28,608                            | 36,395                              |
|   |                          | 141,062                           | 288,231                             |
| Less accumulated depreciation                   |                          | (5,131)                           | (156,861)                           |
|   |                          | <u>\$ 135,931</u>                 | <u>\$ 131,370</u>                   |

**8. Goodwill and Other Intangible Assets:**

SFAS 142 requires goodwill to be allocated and tested at the reporting unit level. The Company's reporting units are ARM, CRM and Portfolio Management. In connection with the Transaction, the Company allocated \$583.3 million of the purchase price to goodwill. CRM's goodwill balance includes \$17.2 million from the acquisition of Star Contact on December 18, 2006 (note 4). The Company's reporting units had the following goodwill (amounts in thousands):

|                      | Successor<br>December 31,<br>2006 | Predecessor<br>December 31,<br>2005 |
|----------------------|-----------------------------------|-------------------------------------|
| ARM                  | \$ 323,533                        | \$ 545,461                          |
| Portfolio Management | 155,377                           | 33,572                              |
| CRM                  | 121,636                           | 89,799                              |
|                      | <u>\$ 600,546</u>                 | <u>\$ 668,832</u>                   |

In connection with the Transaction, the Company allocated \$96.6 million of the purchase price to the fair value of the NCO name. The trade name is an indefinite-lived intangible asset and therefore is not subject to amortization.

Other intangible assets subject to amortization consist primarily of customer relationships and non-compete agreements. The following represents the other intangible assets subject to amortization (amounts in thousands):

|                         | Successor<br>December 31, 2006 |                             | Predecessor<br>December 31, 2005 |                             |
|-------------------------|--------------------------------|-----------------------------|----------------------------------|-----------------------------|
|                         | Gross<br>Carrying<br>Amount    | Accumulated<br>Amortization | Gross<br>Carrying<br>Amount      | Accumulated<br>Amortization |
| Customer relationships  | \$ 324,579                     | \$ 5,808                    | \$ 55,917                        | \$ 14,614                   |
| Non-compete agreements  | 2,172                          | 42                          | -                                | -                           |
| Other intangible assets | -                              | -                           | 1,297                            | 905                         |
| Total                   | <u>\$ 326,751</u>              | <u>\$ 5,850</u>             | <u>\$ 57,214</u>                 | <u>\$ 15,519</u>            |

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**8. Goodwill and Other Intangible Assets (continued):**

The Company recorded amortization expense for these other intangible assets of \$10.3 million and \$5.9 million during the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, respectively. The Company recorded amortization expense for other intangible assets of \$9.4 million and \$7.4 million during the years ended December 31, 2005 and 2004, respectively. The following represents the Company's expected amortization expense for each of the next five years from these other intangible assets (amounts in thousands):

|      |           |
|------|-----------|
| 2007 | \$ 48,254 |
| 2008 | 48,271    |
| 2009 | 47,814    |
| 2010 | 46,939    |
| 2011 | 46,633    |

**9. Accrued Expenses:**

Accrued expenses consisted of the following (amounts in thousands):

|   | <u>Successor</u><br>December 31,<br>2006 | <u>Predecessor</u><br>December 31,<br>2005 |
|---|--|--|
| Restructuring costs   | \$ 12,964                                | \$ 5,752                                   |
| Accrued interest  | 12,424                                   | 6,185                                      |
| Accrued rent and other related<br>expense associated with the flood of<br>the Fort Washington locations | 11,152                                   | 8,167                                      |
| Accrued contract labor expenses   | 3,246                                    | 4,189                                      |
| Accrued acquisition costs   | 1,623                                    | 5,723                                      |
| Other accrued expenses  | 32,372                                   | 33,060                                     |
|   | <u>\$ 73,781</u>                         | <u>\$ 63,076</u>                           |

**10. Long-Term Debt:**

Long-term debt consisted of the following (amounts in thousands):

|                                    | <u>Successor</u><br>December 31,<br>2006 | <u>Predecessor</u><br>December 31,<br>2005 |
|------------------------------------|--|--|
| Senior term loan                   | \$ 465,000                               | \$ -                                       |
| Senior revolving credit facility   | 36,000                                   |  |
| Senior subordinated notes          | 200,000                                  | -  |
| Senior notes                       | 165,000                                  | -  |
| Predecessor senior credit facility | -  | 170,500                                    |
| Convertible notes                  | -  | 125,000                                    |
| Nonrecourse credit facility        | 50,952                                   | 65,995                                     |
| Other                              | 1,361                                    | 5,939                                      |
| Less current portion               | (36,692)                                 | (45,600)                                   |
|                                    | <u>\$ 881,621</u>                        | <u>\$ 321,834</u>                          |

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**10. Long-Term Debt (continued):**

The following summarizes the Company's required debt payments (amounts in thousands):

|            |                   |
|------------|-------------------|
| 2007       | \$ 36,692         |
| 2008       | 13,475            |
| 2009       | 8,141             |
| 2010       | 8,260             |
| 2011       | 44,772            |
| Thereafter | <u>806,973</u>    |
|            | <u>\$ 918,313</u> |

*Senior Credit Facility:*

In connection with the Transaction, on November 15, 2006 the Company repaid the Predecessor senior credit facility and entered into a new senior credit facility ("Credit Facility") with a syndicate of financial institutions. The Credit Facility consists of a \$465.0 million term loan and a \$100.0 million revolving credit facility, with an option to allow the Company to increase its borrowing capacity under the revolving credit facility to a maximum of \$200.0 million, subject to obtaining commitments for such incremental capacity from existing or new lenders. A portion of the revolving credit facility is available for letters of credit and swingline loans, each not to exceed \$20.0 million. The Company is required to make quarterly repayments of \$1.2 million on the term loan until the maturity date of May 15, 2013, at which time the remaining balance outstanding is due. The Company is also required to make annual prepayments, beginning in 2007, of 50 percent, 25 percent or zero percent of its excess annual cash flow, based on its leverage ratio. The revolving credit facility requires no minimum principal payments until its maturity date of November 15, 2011. At December 31, 2006, the balance outstanding on the revolving credit facility was \$36.0 million. The availability of the revolving credit facility is reduced by any unused letters of credit (\$4.8 million at December 31, 2006). As of December 31, 2006, the Company had \$59.2 million of remaining availability under the revolving credit facility.

All borrowings bear interest at a rate equal to either, at the option of the Company, (i) the higher of the prime rate (8.25 percent at December 31, 2006) or the federal funds rate (5.17 percent at December 31, 2006) plus 0.50 percent, plus a margin of 2.00 percent for the first six months following the date of the Transaction and thereafter plus a margin of 1.50 percent to 2.00 percent based on the Company's funded debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") ratio; or (ii) LIBOR (5.33 percent at December 31, 2006) plus a margin of 3.00 percent for the first six months following the date of the Transaction and thereafter plus a margin of 2.50 percent to 3.00 percent based on the Company's funded debt to EBITDA ratio. The Company is charged a fee on the unused portion of the revolving credit facility of 0.50 percent. The effective interest rate on the Credit Facility was approximately 8.38 percent for the period from July 13, 2006 through December 31, 2006. The Credit Facility also provides that the Company obtain interest rate protection for a period of three years in a notional amount not to be less than 50 percent of the aggregate principal amount of the term loan facility.

Borrowings under the Credit Facility are collateralized by substantially all of the Company's assets. The Credit Facility contains certain financial and other covenants such as maintaining a maximum leverage ratio and a minimum interest coverage ratio, and includes restrictions on, among other things, acquisitions, the incurrence of additional debt, investments, disposition of assets, liens and dividends and other distributions. If an event of default, such as failure to comply with covenants or change of control, were to occur under the Credit Facility, the lenders would be entitled to declare all amounts outstanding under it immediately due and payable and foreclose on the pledged assets. The Company was not able to satisfy the covenants under the Credit Facility to provide its annual financial statements for the year ended December 31, 2006 and its annual forecasts for the year ended December 31, 2007 within their respective deadlines. The Company obtained a waiver for these covenants from the lenders, and as of December 31, 2006, the Company was in compliance with all required financial covenants and was not aware of any other events of default.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**10. Long-Term Debt (continued):**

*Senior Notes and Senior Subordinated Notes:*

In connection with the Transaction, on November 15, 2006 the Company issued \$165.0 million of floating rate senior notes due 2013 (“Senior Notes”) and \$200.0 million of 11 $\frac{7}{8}$  percent senior subordinated notes due 2014 (“Senior Subordinated Notes”) (collectively, “the Notes”). The Notes are guaranteed, jointly and severally, on a senior basis with respect to the Senior Notes and on a senior subordinated basis with respect to the Senior Subordinated Notes, in each case by all of the Company’s existing and future domestic restricted subsidiaries (other than certain subsidiaries and joint ventures engaged in financing the purchase of delinquent accounts receivable portfolios).

The Senior Notes are senior unsecured obligations and are senior in right of payment to all existing and future senior subordinated indebtedness, including the Senior Subordinated Notes, and all future subordinated indebtedness. The Senior Notes bear interest at a rate equal to LIBOR plus 4.875 percent, reset quarterly. The effective interest rate of the Senior Notes was approximately 10.25 percent for the period from July 13, 2006 through December 31, 2006. The Company may redeem the Senior Notes, in whole or in part, at any time on or after November 15, 2008 at varying redemption prices depending on the redemption date, plus accrued and unpaid interest.

The Senior Subordinated Notes are unsecured senior subordinated obligations and are subordinated in right of payment to all existing and future senior indebtedness, including the Senior Notes and borrowings under the Credit Facility. The Company may redeem the Senior Subordinated Notes, in whole or in part, at any time on or after November 15, 2010 at varying redemption prices depending on the redemption date, plus accrued and unpaid interest.

The indentures governing the Notes contain a number of covenants that limit the Company’s and its restricted subsidiaries’ ability, among other things, to: incur additional indebtedness and issue certain preferred stock, pay certain dividends, acquire shares of capital stock, make payments on subordinated debt or make investments, place limitations on distributions from restricted subsidiaries, guarantee indebtedness, sell or exchange assets, enter into transactions with affiliates, create certain liens, engage in unrelated businesses, and consolidate, merge or transfer all or substantially all of the Company’s assets and the assets of its subsidiaries on a consolidated basis. In addition, upon the change of control, the Company is required to offer to repurchase all of the Notes then outstanding, at a purchase price equal to 101 percent of their principal amount, plus any accrued interest to the date of repurchase.

*Predecessor Senior Credit Facility:*

Prior to the Transaction, the Company had a senior credit facility (“Predecessor senior credit facility”) with various participating lenders. The Predecessor senior credit facility was structured as a \$300 million revolving credit facility with an option to allow the Company to increase its borrowing capacity to a maximum of \$400 million, subject to obtaining commitments for such incremental capacity from existing or new lenders. The Predecessor senior credit facility required no minimum principal payments until June 18, 2010, the original maturity date.

All borrowings were at an interest rate equal to either, at the option of the Company, the prime rate or LIBOR plus a margin of 0.75 percent to 1.50 percent, which was determined quarterly based upon the Company’s consolidated funded debt to EBITDA ratio. The Company was charged a fee on the unused portion of the Credit Facility of 0.20 percent to 0.30 percent depending on the Company’s consolidated funded debt to EBITDA ratio. The effective interest rate on the Credit Facility was approximately 5.89 percent and 4.91 percent for the period from January 1, 2006 through November 15, 2006 and the year ended December 31, 2005, respectively.

In connection with the Transaction, on November 15, 2006, the Company repaid the balance outstanding on the Predecessor senior credit facility of \$229.3 million using borrowings under its Credit Facility described above.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**10. Long-Term Debt (continued):**

*Predecessor Convertible Notes:*

The Company had \$125.0 million aggregate principal amount of 4.75 percent Convertible Subordinated Notes that were due April 15, 2006 (“the Convertible Notes”). The Convertible Notes were convertible into NCO common stock at a conversion price of \$32.92 per share. Upon maturity, the Company repaid the Convertible Notes using borrowings under the Predecessor senior credit facility, which was subsequently repaid using borrowings under the Company’s Credit Facility in connection with the Transaction.

*Nonrecourse Credit Facility:*

On June 30, 2005, our subsidiary, Portfolio Management amended and restated its nonrecourse credit facility with a lender and extended its existing exclusivity agreement with such lender through June 30, 2009. The new agreement provides that all purchases of accounts receivable by Portfolio Management with a purchase price in excess of \$1.0 million are first offered to the lender for financing at its discretion. If the lender chooses to participate in the financing of a portfolio of accounts receivable, the financing may be structured, depending on the size and nature of the portfolio to be purchased, either as a borrowing arrangement similar to the original agreement, or under various equity sharing arrangements ranging from 25 percent to 50 percent equity provided by the lender. The lender will finance non-equity borrowings at 70 percent of the purchase price, unless otherwise negotiated, with floating interest at a rate equal to LIBOR plus 2.50 percent. As additional return on the debt financed portfolios, the lender receives a percentage of the residual cash flow, unless otherwise negotiated, which is defined as all cash collections after servicing fees, floating rate interest, repayment of the borrowing, and the initial investment by Portfolio Management, including interest. These borrowings are nonrecourse to the Company and are due two years from the date of each respective loan. The Company may terminate the agreement at any time after June 2007 for a cost of \$250,000 for each remaining month under the agreement. The previous financing arrangement as described below remains in effect for outstanding loans as of June 30, 2005.

Under the prior agreement, all purchases of accounts receivable by Portfolio Management with a purchase price in excess of \$4.0 million must be first offered to the lender for financing at its discretion. The agreement had no minimum or maximum credit authorization. If the lender chose to participate in the financing of a portfolio of accounts receivable, the financing was at 90 percent of the purchase price, unless otherwise negotiated, with floating interest at the prime rate plus 3.25 percent. Debt service payments equal total collections less servicing fees and expenses until each individual borrowing is fully repaid and Portfolio Management’s original investment is returned, including interest. Thereafter, the lender is paid a residual of 40 percent of collections, less servicing costs, unless otherwise negotiated. Individual loans are required to be repaid based on collections, but not more than two years from the date of borrowing.

Borrowings under this financing agreement are nonrecourse to the Company, except for the assets within the entities established in connection with the financing agreement. This loan agreement contains a collections performance requirement, among other covenants, that, if not met, provides for cross-collateralization with any other portfolios financed through the agreement, in addition to other remedies.

Total debt outstanding under this facility was \$51.0 million and \$66.0 million as of December 31, 2006 and 2005, respectively, which included \$13.6 million and \$5.6 million, respectively, of accrued residual interest. The effective interest rate on these loans, including the residual interest component, was approximately 19.7 percent and 12.6 percent for the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, respectively, and 20.4 percent for the year ended December 31, 2005. As of December 31, 2006, Portfolio Management was in compliance with all required covenants.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**10. Long-Term Debt (continued):**

*Nonrecourse Credit Facility (continued):*

Upon full satisfaction of the notes payable and the return of the initial investment by Portfolio Management, including interest, as it relates to each purchase of accounts receivable under the previous agreement, the Company is obligated to pay the lender a contingent payment amount equal to 40 percent of collections received, unless otherwise negotiated, net of servicing fees and other related charges. The contingent payment has been accounted for as an embedded derivative in accordance with SFAS 133. At issuance, the loan proceeds received were allocated to the note payable and the embedded derivative. The resulting original issue discount on the note payable is amortized to interest expense through maturity using the effective interest method. At December 31, 2006 and 2005, the estimated fair value of the embedded derivative was \$13.6 million and \$5.6 million, respectively. The embedded derivative for each portfolio purchase is subject to market rate revaluation each period. Absent a readily available market for such embedded derivatives, the Company bases its revaluation on similar current period portfolio purchases' underlying yields. During the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, \$162,000 of "Other income" and \$5,000 of "Other expense," respectively, was recorded on the statement of operations to reflect the revaluation of the embedded derivatives. During the year ended December 31, 2005, \$56,000 was recorded as "Other income" on the statement of operations to reflect the revaluation of the embedded derivatives.

As part of the exclusivity agreement described above, Portfolio Management has a joint venture agreement ("the Agreement") with the lender of the nonrecourse credit facility to purchase larger portfolios, whereby Portfolio Management owns 65 percent of the joint venture and is the managing member, and the lender owns the remaining 35 percent interest. Each party finances the joint venture based on predetermined percentages as negotiated for each portfolio purchase. The Agreement was established to purchase accounts receivable at the discretion of Portfolio Management, and the joint venture is consolidated into Portfolio Management's results of operations with a minority interest representing the lender's equity ownership. At December 31, 2006 and 2005, the Company had \$12.2 million and \$5.8 million, respectively, of debt outstanding under the joint venture, which is included in the nonrecourse credit facility debt outstanding disclosed above.

**11. Operating Leases:**

The Company leases certain equipment and real estate facilities under noncancelable operating leases. These leases expire between 2007 and 2016, and most contain renewal options. The following represents the future minimum payments, by year and in the aggregate, under noncancelable operating leases with initial or remaining terms of one year or more. The following future minimum payments have been reduced by minimum sublease rentals of \$5.0 million, due in the future under noncancelable subleases, and do not include the leases from the Company's former Fort Washington locations (note 18) (amounts in thousands).

|            |                   |
|------------|-------------------|
| 2007       | \$ 44,059         |
| 2008       | 39,819            |
| 2009       | 33,767            |
| 2010       | 27,838            |
| 2011       | 26,618            |
| Thereafter | 38,832            |
|            | <u>\$ 210,933</u> |

Rent expense was \$34.0 million and \$5.2 million for the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, respectively. Rent expense was \$35.0 million and \$27.9 million for the years ended December 31, 2005 and 2004, respectively. The total amount of base rent payments is being charged to expense on the straight-line method over the term of the lease.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**12. Income Taxes:**

Income tax (benefit) expense consisted of the following components (amounts in thousands):

|                                 | Successor   | Predecessor   |   |                  |
|---------------------------------|---|---|---|------------------|
|                                 | Period from<br>July 13<br>through<br>December 31,<br>2006 | Period from<br>January 1<br>through<br>November 15,<br>2006 | For the Years Ended<br>December 31,<br>2005      2004 |                  |
| Currently payable:              |   |   |   |                  |
| Federal                         | \$ -  | \$ (228)  | \$ (69)   | \$ 360           |
| State                           | 18  | 55  | 331   | 1,586            |
| Foreign                         | 65  | 1,385   | 1,003   | 1,768            |
| Deferred:                       |   |   |   |                  |
| Federal                         | (3,602)   | 11,553  | 22,801  | 25,470           |
| State                           | (254)   | 858   | 1,417   | 1,194            |
| Foreign                         | (4)   | 1,119   | 699   | 2,011            |
| Income tax (benefit)<br>expense | <u>\$ (3,777)</u>   | <u>\$ 14,742</u>  | <u>\$ 26,182</u>                                      | <u>\$ 32,389</u> |

Deferred tax assets (liabilities) consisted of the following (amounts in thousands):

|                                  | Successor            | Predecessor          |
|----------------------------------|----------------------|----------------------|
|                                  | December 31,<br>2006 | December 31,<br>2005 |
| Deferred tax assets:             |                      |                      |
| Net operating loss carryforwards | \$ 73,557            | \$ 40,158            |
| Deferred contractual revenue     | 811                  | 446                  |
| Accrued acquisition costs        | 1,661                | 2,544                |
| Accrued expenses                 | 11,120               | 15,070               |
| Total deferred tax assets        | 87,149               | 58,218               |
| Valuation allowance              | 18,425               | 14,395               |
| Net deferred tax assets          | 68,724               | 43,823               |
| Deferred tax liabilities:        |                      |                      |
| Intangible assets                | 134,504              | 37,352               |
| Prepaid expenses                 | 2,837                | 4,962                |
| Depreciation                     | 8,126                | 11,126               |
| Purchased accounts receivable    | 52,539               | 32,437               |
| Total deferred tax liabilities   | 198,006              | 85,877               |
| Net deferred tax liabilities     | <u>\$ (129,282)</u>  | <u>\$ (42,054)</u>   |

The Company had a \$47.8 million deferred tax asset for federal net operating loss carryforwards of \$136.7 million, subject to certain limitations, at December 31, 2006, which will expire during 2007 through 2026. These federal net operating loss carryforwards primarily relate to net operating loss carryforwards created during 2006. The Company had \$53.3 million of federal net operating loss carryforwards at December 31, 2005.

The Company had a \$3.3 million deferred tax asset for Canadian net operating loss carryforwards of \$9.5 million at December 31, 2006, which will expire in 2012. The Company had \$12.5 million of Canadian net operating loss carryforwards at December 31, 2005.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**12. Income Taxes (continued):**

The Company had deferred tax assets for state net operating loss carryforwards of \$22.0 million at December 31, 2006. The deferred tax assets created by the state net operating loss carryforwards have been reduced by a \$18.4 million valuation allowance based on the Company's assessment that it is more likely than not that such amounts will not be realized. This represents an increase of \$4.0 million from December 31, 2005, due to additional state net operating loss carryforwards generated in 2006. To the extent that any portion of this valuation allowance is subsequently recognized as a tax benefit, the benefit of such loss utilization will be recorded as a reduction to goodwill.

The portfolios of purchased accounts receivable are composed of distressed debt. Collection results are not guaranteed until received; accordingly, for tax purposes, any gain on a particular portfolio is deferred until the full cost of its acquisition is recovered. Revenue for financial reporting purposes is recognized ratably over the life of the portfolio. Deferred tax liabilities arise from deferrals created during the early stages of the portfolio. These deferrals reverse after the cost basis of the portfolio is recovered.

A reconciliation of the U.S. statutory income tax rate to the effective rate was as follows:

|                                | Successor   | Predecessor   |   |              |
|--------------------------------|---|---|---|--------------|
|                                | Period from<br>July 13<br>through<br>December 31,<br>2006 | Period from<br>January 1<br>through<br>November 15,<br>2006 | For the Years Ended<br>December 31,<br>2005      2004 |              |
| U.S. statutory income tax rate | 35.0%   | 35.0%   | 35.0%   | 35.0%        |
| State taxes, net of federal    | 1.5   | 1.6   | 1.3   | 2.3          |
| Other, net                     | 0.6   | 0.6   | 0.1   | 0.9          |
| Effective tax rate             | <u>37.1%</u>  | <u>37.2%</u>  | <u>36.4%</u>  | <u>38.2%</u> |

Pre-tax income from operations included foreign subsidiary income of \$7.6 million and \$254,000 for the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, respectively. Pre-tax income from operations for the years ended December 31, 2005 and 2004, included foreign subsidiary income of \$4.7 million and \$12.5 million, respectively. The Company's cumulative undistributed earnings of foreign subsidiaries of \$29.6 million and \$29.5 million for the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, respectively, are expected to be reinvested indefinitely, and accordingly no incremental U.S. or foreign withholding taxes have been recorded.

**13. Stockholders' Equity:**

The following summarizes the Company's share activity (shares in thousands):

|                                | Successor    |                   | Predecessor          |
|--------------------------------|--------------|-------------------|----------------------|
|                                | Preferred    | Class L<br>Common | Class A<br>Common    |
| <i>Predecessor:</i>            |              |                   |                      |
| Balance, January 1, 2004       |              |                   | 25,988               |
| Acquisitions                   |              |                   | 5,184                |
| Stock-based compensation plans |              |                   | 890                  |
| Exercise of warrants           |              |                   | 16                   |
| Balance, December 31, 2004     |              |                   | <u>32,078</u>        |
| Stock-based compensation plans |              |                   | 98                   |
| Balance, December 31, 2005     |              |                   | <u>32,176</u>        |
| Stock-based compensation plans |              |                   | 240                  |
| Balance, November 15, 2006     |              |                   | <u><u>32,416</u></u> |
| <i>Successor:</i>              |              |                   |                      |
| Capitalization of Company      | 1,220        | 364               | 1,616                |
| Balance, December 31, 2006     | <u>1,220</u> | <u>364</u>        | <u>1,616</u>         |

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**13. Stockholders' Equity (continued):**

*Successor:*

Capital Stock:

The Company is authorized to issue three classes of capital stock: Preferred Stock, par value \$0.01 per share, Class L Common Stock, par value \$0.01 per share ("Class L") and Class A common stock, par value \$0.01 per share ("Class A"). Shares of Class L, Class A and one series of Preferred Stock, Series A 14 percent PIK Preferred Stock ("Series A"), are issued and outstanding.

For both Series A and Class L, dividends accrue at an annual rate of 14 percent. Dividends on Series A are "paid-in-kind" in newly issued shares of Series A. For Series A, dividends accrue on the unreturned initial investment in Series A and the unreturned value of Series A issued as a paid-in-kind dividend. For Class L, dividends are compounding and accrue on the unreturned initial investment in Class L, excluding the portion of such investment that is attributable to the right of Class L to share generally in distributions.

Series A and Class L, in the aggregate, have a preference on distributions (excluding paid-in-kind dividends) allocated as follows: first to unpaid yield accruing on Class L or Series A and the unreturned value of Series A issued in a paid-in-kind dividend, and second to the unreturned initial investment in Class L, excluding the portion of such investment that is attributable to the right of Class L to share generally in distributions, and the unreturned initial investments in Series A. Once this preference has been paid in full, all remaining distributions are payable to Class L and Class A on a pro-rata basis.

Series A is not entitled to vote, and Class L and Class A vote together as a single class, with each share entitled to one vote. In addition, the Company may not enter into an agreement or consummate a transaction that would result in a change of control or an initial public offering without the consent of the holders of a majority of the then outstanding shares of Series A and Class L voting as a single class.

Stock-based Compensation:

On November 15, 2006, the Company adopted the Collect Holdings, Inc. Restricted Share Plan (the "Restricted Share Plan") and authorized grants of restricted shares of the Company to management. The Restricted Share Plan is administered by the Compensation Committee of the Board of Directors, which approved the grants to employees recommended by the Company's chief executive officer. A total of 220,055 restricted shares are authorized under the Restricted Share Plan. Shares of restricted stock granted under the Restricted Share Plan vest in 25 percent increments over a period of four years, provided that the recipient remains employed by the Company. On November 17, 2006, an aggregate of 164,492 restricted shares of Class A common stock were awarded under the Restricted Share Plan. Compensation expense recognized related to Restricted Share Plan awards for the period from July 13, 2006 through December 31, 2006 was \$49,000. At December 31, 2006, there was \$1.6 million of unrecognized pre-tax compensation cost related to the non-vested restricted shares. The Company measures compensation expense based on the grant date fair value, and has elected to recognize this compensation expense on a straight-line basis over the weighted-average service period, which is expected to be four years.

*Predecessor:*

Stock-based Compensation:

On November 15, 2006, in connection with the Transaction and in accordance with the terms of the equity awards, the vesting of all outstanding unvested options to purchase the Company's stock and restricted stock units was accelerated, and the Company recorded compensation expense of approximately \$5.1 million for the acceleration.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**13. Stockholders' Equity (continued):**

*Predecessor (continued):*

Stock-based Compensation (continued):

The Company maintained stock option plans and an equity incentive plan for certain employees under which fixed price stock options were granted and the option price was generally not less than the fair value of a share of the underlying stock at the date of grant (collectively, the "NCO Option Plans"). Option terms were generally 10 years, with options generally becoming exercisable ratably over three years, or one year for outside directors, from the date of grant.

The fair value of each stock option was estimated on the date of grant using the Black-Scholes option-pricing model that used the assumptions noted in the following table. Expected volatility was based on a blend of implied and historical volatility of the Company's predecessor common stock. The Company used historical data on exercises of stock options and other factors to estimate the expected term of the share-based payments granted. The risk free rate was based on the U.S. Treasury yield curve in effect at the date of grant. The fair value of each predecessor common stock option granted was estimated using the following weighted-average assumptions:

|                         | Period from<br>January 1<br>through<br>November 15,<br>2006 | For the Years Ended<br>December 31, |       |
|-------------------------|---|-------------------------------------|-------|
|                         |   | 2005                                | 2004  |
| Risk-free interest rate | 4.5%  | 3.8%                                | 3.5%  |
| Expected life in years  | 5.4   | 5.4                                 | 4.0   |
| Volatility factor       | 37.4%   | 37.0%                               | 36.9% |
| Dividend yield          | None  | None                                | None  |

The following summarizes the activity of the NCO Option Plans (amounts in thousands, except per share amounts):

|                                  | Number of<br>Options | Weighted<br>Average<br>Exercise Price<br>Per Share |
|----------------------------------|----------------------|--|
| Outstanding at January 1, 2004   | 4,477                | \$ 23.50   |
| Granted                          | 256                  | 24.53  |
| Assumed from acquisitions        | 508                  | 20.78  |
| Exercised                        | (819)                | 18.62  |
| Forfeited                        | (363)                | 26.43  |
| Outstanding at December 31, 2004 | 4,059                | 23.94  |
| Granted                          | 661                  | 21.10  |
| Exercised                        | (82)                 | 17.31  |
| Forfeited                        | (251)                | 24.05  |
| Outstanding at December 31, 2005 | 4,387                | 23.65  |
| Granted                          | 294                  | 17.27  |
| Exercised                        | (3,617)              | 20.87  |
| Forfeited                        | (904)                | 30.25  |
| Expired                          | (37)                 | 19.87  |
| Outstanding at November 15, 2006 | 123                  | 43.68  |
| Forfeited                        | (116)                | 44.44  |
| Outstanding at December 31, 2006 | 7                    | \$ 30.05   |

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**13. Stockholders' Equity (continued):**

*Predecessor (continued):*

Stock-based Compensation (continued):

As a result of the Transaction, effective as of November 16, 2006 all remaining outstanding stock options are only exercisable for \$27.50 per share in cash (the Transaction purchase price per share). All of the stock options outstanding as of December 31, 2006, had an exercise price in excess of \$27.50. Because these stock options were granted under the NCO Group, Inc. 1996 Stock Option Plan, the Company does not have the authority under that plan to cancel the remaining options. These options will expire according to their original terms unless previously exercised for \$27.50 per share in cash.

The weighted-average fair value at date of grant of a common stock option during the period from January 1, 2006 through November 15, 2006 was \$7.20. The total intrinsic value (market value on date of exercise less exercise price) of options exercised during the period from January 1, 2006 through November 15, 2006 was \$23.3 million. For the period from January 1, 2006 through November 15, 2006, the Company had \$20.0 million of excess cash tax benefit that was not recorded as a financing cash inflow due to the existence of net operating loss carryforwards.

Cash received from option exercises under all share-based payment arrangements for the period from January 1, 2006 through November 15, 2006 was \$3.9 million. The actual tax benefit recognized for the tax deductions from predecessor option exercises under all share-based payment arrangements for the period from January 1, 2006 through November 15, 2006 was \$496,000.

The Company recognizes the cost of stock option grants to employees over the vesting period based on their fair values. Compensation expense recognized related to stock option awards for the period from January 1, 2006 through November 15, 2006 was \$2.1 million, including \$1.5 million for the acceleration of vesting in connection with the Transaction.

The Company maintained an equity incentive plan under which certain employees and directors ("Participant") were granted restricted share unit awards in the Company's common stock (the "Restricted Stock Plan"). Awards of restricted share units were valued by reference to shares of common stock that entitled a Participant to receive, upon the settlement of the unit, one share of common stock for each unit. The awards vested over multiple cliff vesting periods and/or based on meeting performance-based targets, and did not have voting rights. The following summarizes the activity of the Restricted Stock Plan for the period from January 1, 2006 through November 15, 2006 (amounts in thousands, except per share amounts):

|                                      | Number of<br>Non-vested<br>Share Unit<br>Awards | Weighted<br>Average<br>Grant Date<br>Fair Value |
|--------------------------------------|---|---|
| Unvested awards at January 1, 2006   | 278   | \$ 21.34  |
| Granted                              | 17  | 25.69   |
| Awards vested                        | (295)   | 21.59   |
| Unvested awards at November 15, 2006 | -   | \$ -  |

Compensation expense recognized related to restricted share unit awards for the period from January 1, 2006 through November 15, 2006 was \$5.0 million, including \$3.6 million for the acceleration of vesting in connection with the Transaction. For the year ended December 31, 2005, the Company granted 139,321 shares of restricted share units with a weighted average price of \$17.83 per share, and recorded compensation expense of \$1.3 million. For the year ended December 31, 2004, the Company granted 174,765 shares of restricted share units with a weighted average price of \$24.88 per share, and recorded compensation expense of \$683,000.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**14. Derivative Financial Instruments:**

The Company enters into forward exchange contracts to minimize the impact of currency fluctuations on transactions and cash flows. These contracts are designated as cash flow hedges. The Company had forward exchange contracts for the purchase of \$114.1 million and \$47.3 million of Canadian dollars outstanding at December 31, 2006 and 2005, respectively, which mature throughout the remainder of 2007. For the period from January 1, 2006 through November 15, 2006, the Company recorded net gains of \$2.5 million (\$1.5 million after tax) in "Other comprehensive income (loss)" for the change in fair value, and net gains of \$4.4 million (\$2.8 million after tax) were reclassified into earnings. For the period from January 1, 2006 through November 15, 2006, the Company recorded net gains of \$566,000 (\$362,000 after tax) representing the ineffectiveness of certain cash flow hedges. For the period from July 13, 2006 through December 31, 2006, the Company recorded net losses of \$2.5 million (\$1.5 million after tax) in "Other comprehensive income (loss)" for the change in fair value, and net losses of \$229,000 (\$141,000 after tax) were reclassified into earnings. For the year ended December 31, 2005, the Company recorded net gains of \$1.5 million (\$933,000 after tax) in "Other comprehensive income (loss)" for the change in fair value, and net gains of \$1.5 million (\$943,000 after tax) were reclassified into earnings. For the year ended December 31, 2004, the Company recorded net gains of \$2.7 million (\$1.9 million after tax) in "Other comprehensive income (loss)" for the change in fair value, and net gains of \$2.4 million (\$1.6 million after tax) were reclassified into earnings. The impact of the settlement of the Company's cash flow hedges was recorded in "Payroll and related expenses", "Selling, general and administrative expenses" and "Other income (expense)" in the statement of operations. At December 31, 2006 and 2005, the fair market value of all outstanding forward exchange contracts was a net liability of \$4.1 million, which was included in "Other liabilities" and a net asset of \$436,000, which was included in "Other assets," respectively. All of the accumulated gains and losses in "Other comprehensive income (loss)" related to cash flow hedges at December 31, 2006 and 2005 is expected to be reclassified into earnings within the next 12 months.

The Company's nonrecourse credit facility relating to purchased accounts receivable contains contingent payments that are accounted for as embedded derivatives. The contingent payment is equal to a percentage of collections received after principal and interest, unless otherwise negotiated, net of servicing fees and other related charges. At issuance, the loan proceeds received were allocated to the note payable and the embedded derivative. The resulting original issue discount on the note payable is amortized to interest expense through maturity using the effective interest method. At December 31, 2006 and 2005, the estimated fair value of the embedded derivative was \$13.6 million and \$5.6 million, respectively. The embedded derivative for each portfolio purchase is subject to market rate revaluation each period. Absent a readily available market for such embedded derivatives, the Company bases its revaluation on similar current period portfolio purchases' underlying yields. During the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, \$162,000 of "Other income" and \$5,000 of "Other expense," respectively, was recorded on the statement of operations to reflect the revaluation of the embedded derivatives.

The Company enters into interest rate cap contracts to minimize the impact of LIBOR fluctuations on transactions and cash flows. The Company had interest rate caps covering a notional amount of \$115.0 million at December 31, 2006, with a weighted average LIBOR cap rate of 6.00 percent. The aggregate notional amount of the interest rate caps is subject to quarterly reductions that will reduce the notional amount to \$100.0 million after two years, where it will remain until maturity on January 6, 2009. For the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, the Company recorded \$69,000 and \$10,000, respectively, of interest expense from the amortization of the original cost of the interest rate caps. The interest rate caps are adjusted to their fair market value each period and the difference, if any, is recorded in "Other income (expense)" in the statement of operations. For the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, the Company recorded reductions of \$84,000 and \$5,000, respectively, in "other expense" for the changes in the fair market value of the interest rate caps. As of December 31, 2006, the fair market value of all outstanding interest rate caps was \$83,000, which is included in "other assets."

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**14. Derivative Financial Instruments (continued):**

On November 30, 2006, the Company entered into interest rate swap agreements to minimize the impact of LIBOR fluctuations on interest payments on the Company's floating rate debt. The interest rate swaps cover an aggregate notional amount of \$189.0 million and are effective as of February 22, 2007, which is the first interest payment date. The aggregate notional amount of the interest rate swaps is subject to quarterly reductions beginning on November 22, 2008 through maturity on November 22, 2009. The Company is required to pay the counterparties quarterly interest payments at a weighted average fixed rate of 4.77%, and receives from the counterparties variable quarterly interest payments based on LIBOR. The net interest paid or received will be included in "interest expense." The interest rate swaps are designated as cash flow hedges, and, accordingly, changes in fair market value will be recorded, net of tax, in "other comprehensive income (loss)."

**15. Fair Value of Financial Instruments:**

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value:

*Cash and Cash Equivalents, Trade Accounts Receivable, and Accounts Payable:*

The carrying amount reported in the balance sheets approximates fair value because of the short maturity of these instruments.

*Purchased Accounts Receivable:*

The Company records purchased accounts receivable at cost, which is discounted from the contractual receivable balance. The carrying value of purchased accounts receivable, which is estimated based upon future cash flows, approximates fair value at December 31, 2006 and 2005.

*Notes Receivable:*

The Company had notes receivable of \$8.9 million and \$11.2 million as of December 31, 2006 and 2005, respectively. The carrying amounts reported in the balance sheets, included in current and long-term other assets, approximated market rates for notes with similar terms and maturities, and, accordingly, the carrying amounts approximated fair value. The Company reviews the recoverability of the notes receivable on a quarterly basis to determine if an impairment charge is required.

*Long-Term Debt:*

The stated interest rates of the Company's debt approximate market rates for debt with similar terms and maturities, and, accordingly, the carrying amounts approximate fair value.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**16. Supplemental Cash Flow Information:**

The following are supplemental disclosures of cash flow information (amounts in thousands):

|   | Successor   | Predecessor   |                                     |           |
|---|---|---|-------------------------------------|-----------|
|   | Period from<br>July 13<br>through<br>December 31,<br>2006 | Period from<br>January 1<br>through<br>November 15,<br>2006 | For the Years Ended<br>December 31, |           |
|   |   |   | 2005                                | 2004      |
| Cash paid for interest  | \$ 6,978  | \$ 26,806   | \$ 21,934                           | \$ 22,448 |
| Cash paid for income taxes                                      | 5,816   | 2,209   | 15,539                              | 12,280    |
| Noncash investing and financing activities:                     |   |   |                                     |           |
| Fair value of assets acquired                                   | 1,657,361   | 4,911   | 252,600                             | 231,610   |
| Common stock issued for acquisitions                            | -   | -   | -                                   | 128,699   |
| Liabilities assumed from acquisitions                           | 399,630   | 1,615   | 38,790                              | 103,018   |
| Nonrecourse borrowings to purchase accounts receivable          | -   | 1,025   | 17,213                              | 42,832    |
| Dissolution of securitized nonrecourse debt and other assets    | -   | -   | 6,399                               | 13,673    |
| Deferred portion of purchased accounts receivable               | -   | -   | -                                   | 3,288     |
| Contribution of note receivable for acquisition                 | -   | -   | 5,154                               | -         |
| Elimination of equity investment in connection with acquisition | -   | -   | 2,780                               | -         |
| Adjustment to acquisition accruals                              | -   | 7,465   | 3,820                               | -         |
| Deferred compensation from restricted stock units               | -   | -   | 2,523                               | 4,141     |
| Note receivable from disposal of net assets                     | -   | -   | -                                   | 2,040     |
| Disposal of fixed assets  | -   | 1,336   | 1,128                               | -         |

Nonrecourse borrowings to purchase accounts receivable represent Portfolio Management's purchases of large accounts receivable portfolios financed through the nonrecourse credit facility prior to August 2005. These borrowings were noncash transactions since the lender sent payments directly to the seller of the accounts. After August 2005, all borrowings under the nonrecourse credit facility were sent directly to the Company.

**17. Employee Benefit Plans:**

The Company has a savings plan under Section 401(k) of the Internal Revenue Code, referred to as the Plan, for its U.S. employees. The Plan allows all eligible employees to defer up to 15 percent of their income on a pretax basis through contributions to the Plan, subject to limitations under Section 401(k) of the Internal Revenue Code. The Company will provide a matching contribution of 25 percent of the first six percent of an employee's contribution. The Company also has similar type plans for its international employees. The charges to operations for the matching contributions were \$1.1 million and \$265,000 for the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006. The charges to operations for the matching contributions were \$2.7 million, \$3.1 million and \$2.4 million for 2005, 2004 and 2003, respectively.

The Company has a deferred compensation plan, referred to as the Deferred Compensation Plan, to permit eligible employees of the Company to defer receipt and taxation of their compensation from the Company each year up to the limit in effect under Section 402(g) of the Internal Revenue Code, less amounts contributed to the Deferred Compensation Plan. The Company, at its discretion, may make a contribution that will be allocated among participants in proportion to their deferrals for such year. All executive officers and other key employees designated by the Company are eligible to participate in the Deferred Compensation Plan.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**18. Commitments and Contingencies:**

*Purchase Commitments:*

The Company enters into noncancelable agreements with various telecommunications companies, a foreign labor subcontractor in India, and other vendors that require minimum purchase commitments. These agreements expire between 2007 and 2009. The following represents the future minimum payments, by year and in the aggregate, under noncancelable purchase commitments (amounts in thousands):

|      |                  |
|------|------------------|
| 2007 | \$ 43,324        |
| 2008 | 15,153           |
| 2009 | <u>1,966</u>     |
|      | <u>\$ 60,443</u> |

The Company incurred \$52.1 million and \$6.7 million of expense connection with these purchase commitments for the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, respectively, and \$48.4 million and \$33.2 million of expense for the years ended December 31, 2005 and 2004, respectively.

*Forward-Flow Agreements:*

The Company has several fixed price agreements, or forward-flows, that obligate the Company to purchase, on a monthly basis, portfolios of charged-off accounts receivable meeting certain criteria. At December 31, 2006, the Company had forward-flows aggregating approximately \$3.6 million per month, expiring between April 2007 and October 2011. The terms of the agreements vary; they can be terminated with either 30 days, 60 days or 90 days written notice.

*Litigation and Investigations:*

The Company is party, from time to time, to various legal proceedings, regulatory investigations and tax examinations incidental to its business. The Company continually monitors these legal proceedings, regulatory investigations and tax examinations to determine the impact and any required accruals.

**Fort Washington Flood:**

In June 2001, the first floor of the Company's Fort Washington, Pennsylvania, headquarters was severely damaged by a flood caused by remnants of Tropical Storm Allison. The Company subsequently decided to relocate its corporate headquarters to Horsham, Pennsylvania. The Company filed a lawsuit in the Court of Common Pleas, Montgomery County, Pennsylvania (Civil Action No. 01-15576) against the current landlord and the former landlord of the Fort Washington facilities to terminate the leases and to obtain other relief. The landlord and the former landlord filed counter-claims against the Company. The Company maintains a reserve that it believes is adequate to address its exposure to this matter and plans to continue to contest this matter.

**U.S. Department of Justice:**

On February 24, 2006, the U.S. Department of Justice alleged certain civil damages of approximately \$5.0 million. The alleged damages relate to a matter the Company reported to federal authorities and the client in 2003 involving three employees who engaged in unauthorized student loan consolidations in connection with a client contract. The responsible employees were terminated at that time in 2003. The Company does not agree with the allegations regarding damages and has and will continue to engage in discussions with the Department of Justice in an effort to amicably resolve the matter. The Company has been advised and expects that actual damages incurred as a result of this incident, if any, will be covered by insurance.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**18. Commitments and Contingencies (continued):**

*Litigation and Investigations (continued):*

Tax Matters:

In 2004, the Company received notice of a proposed reassessment from a foreign taxing authority relating to certain matters occurring from 1998 through 2001 regarding one of the Company's subsidiaries. In September 2006, the Company received the formal notice of reassessment in the amount of \$14.6 million including interest and penalties (converted as of December 31, 2006), and in December 2006 the Company paid a deposit of \$8.5 million including interest. The Company maintains a reserve that it believes is adequate to address its exposure to this matter and has contested the reassessment.

New York and Massachusetts Attorneys General:

In August 2006, the Company received a subpoena from the New York Attorney General and in September 2006 the Company received a letter from the Massachusetts Attorney General requesting information relating to the Company's debt collection practices in such states. The Company is in the process of responding to such inquires or investigations and providing certain information to the Attorneys General offices in connection with the letters. The Company believes it is in compliance with the state laws of New York and Massachusetts relating to debt collection practices in all material respects. However no assurance can be given that any such inquiries or investigations will not result in a formal investigation or an enforcement action. Any such enforcement actions could result in fines as well as the suspension or termination of the Company's ability to conduct business in such states.

Other:

The Company is involved in other legal proceedings, regulatory investigations and tax examinations from time to time in the ordinary course of its business. Management believes that none of these other legal proceedings, regulatory investigations or tax examinations will have a materially adverse effect on the financial condition or results of operations of the Company.

**19. Segment Reporting:**

On November 15, 2006, the Company reorganized its business segments in connection with a management realignment. The ARM North America and ARM International segments have been combined and renamed ARM. The information presented below has been restated to reflect this reorganization.

As of December 31, 2006, the Company's business consisted of three operating divisions: ARM, CRM and Portfolio Management. The accounting policies of the segments are the same as those described in note 2, "Accounting Policies."

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**19. Segment Reporting (continued):**

ARM provides accounts receivable management services to consumer and commercial accounts for all market sectors including financial services, healthcare, retail and commercial, telecommunications, utilities, education, and government. ARM serves clients of all sizes in local, regional and national markets in the United States, Canada, the United Kingdom and Australia. In addition to traditional accounts receivable collections, these services include developing the client relationship beyond bad debt recovery and delinquency management, and delivering cost-effective accounts receivable solutions to all market sectors. For the years ended December 31, 2006 and 2005, ARM received \$687.3 million and \$670.5 million, respectively, of revenue from U.S. customers, \$36.0 million and \$31.9 million, respectively, of revenue from Canadian customers and \$25.5 million and \$14.7 million, respectively, of revenue from U.K. customers. For the year ended December 31, 2006, ARM received \$3.5 million of revenue from Australian customers. ARM had total assets, net of any intercompany balances, of \$932.2 million, \$842.6 million and \$766.9 million at December 31, 2006, 2005 and 2004, respectively. ARM had capital expenditures of \$28.9 million and \$2.0 million for the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, respectively. For the years ended December 31, 2005 and 2004, ARM had capital expenditures of \$28.0 million and \$24.0 million, respectively. ARM also provides accounts receivable management services to Portfolio Management. ARM recorded revenue of \$101.8 million and \$12.0 million for these services for the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, respectively, and \$87.0 million and \$63.1 million for these services for the years ended December 31, 2005 and 2004, respectively. Included in ARM's intercompany revenue for the year ended December 31, 2006, was \$10.3 million of commissions from the sale of portfolios by Portfolio Management.

The CRM division provides customer relationship management services to clients in the United States and Canada through offices in the United States, Canada, the Philippines and Panama. The Company's acquisition of Star Contact in December 2006 was included in the CRM segment. For the years ended December 31, 2006 and 2005, CRM received \$238.5 million and \$186.0 million from U.S. customers, respectively, and \$12.7 million and \$4.4 million, respectively, from Canadian customers. CRM had total assets, net of any intercompany balances, of \$287.7 million, \$201.7 million and \$183.6 million at December 31, 2006, 2005 and, respectively. CRM had capital expenditures of \$11.9 million and \$202,000 for the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, respectively. For the years ended December 31, 2005 and 2004, CRM had capital expenditures of \$15.5 million and \$3.2 million, respectively. In November 2006, CRM began providing certain services to ARM. CRM recorded revenue of \$9,000 and \$354,000 for these services for the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, respectively.

Portfolio Management purchases and manages defaulted consumer accounts receivable from consumer creditors such as banks, finance companies, retail merchants, utilities, healthcare companies and other consumer oriented companies. The Company's acquisition of the purchased portfolio assets of RMA and the acquisition of Marlin was included in the Portfolio Management segment. Portfolio Management had total assets, net of any intercompany balances, of \$424.2 million, \$283.7 million and \$163.4 million at December 31, 2006, 2005 and 2004, respectively.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**19. Segment Reporting (continued):**

The following tables present the revenue, payroll and related expenses, selling, general and administrative expenses, and earnings before interest, taxes, depreciation, and amortization (“EBITDA”) for each segment. EBITDA is used by the Company’s management to measure the segments’ operating performance and is not intended to report the segments’ operating results in conformity with generally accepted accounting principles.

| Successor   |                   |                                    |  |                 |
|---|-------------------|------------------------------------|--|-----------------|
| For the period from July 13 through December 31, 2006 |                   |                                    |  |                 |
| (amounts in thousands)                                |                   |                                    |  |                 |
|   | Revenue           | Payroll and<br>Related<br>Expenses | Selling, General<br>and Admin.<br>Expenses | EBITDA          |
| ARM   | \$ 103,920        | \$ 47,797                          | \$ 42,267                                  | \$ 13,856       |
| CRM   | 35,213            | 28,167                             | 5,576                                      | 1,470           |
| Portfolio Management                                  | 13,489            | 1,001                              | 11,906                                     | 582             |
| Eliminations  | (12,326)          | (354)                              | (11,972)                                   | -               |
| <b>Total</b>  | <b>\$ 140,296</b> | <b>\$ 76,611</b>                   | <b>\$ 47,777</b>                           | <b>\$15,908</b> |

| Predecessor   |                     |                                    |  |                         |                   |
|---|---------------------|------------------------------------|--|-------------------------|-------------------|
| For the period from January 1 through November 15, 2006 |                     |                                    |  |                         |                   |
| (amounts in thousands)                                  |                     |                                    |  |                         |                   |
|   | Revenue             | Payroll and<br>Related<br>Expenses | Selling, General<br>and Admin.<br>Expenses | Restructuring<br>Charge | EBITDA            |
| ARM   | \$ 762,141          | \$ 371,384                         | \$ 326,636                                 | \$ 12,297               | \$ 51,824         |
| CRM   | 215,949             | 175,401                            | 39,148                                     | 468                     | 932               |
| Portfolio Management                                    | 173,474             | 7,107                              | 111,120                                    | -                       | 55,247            |
| Eliminations  | (101,763)           | (9)                                | (101,754)                                  | -                       | -                 |
| <b>Total</b>  | <b>\$ 1,049,801</b> | <b>\$ 553,883</b>                  | <b>\$ 375,150</b>                          | <b>\$ 12,765</b>        | <b>\$ 108,003</b> |

| Predecessor                          |                     |                                    |  |                         |                   |
|--------------------------------------|---------------------|------------------------------------|--|-------------------------|-------------------|
| For the year ended December 31, 2005 |                     |                                    |  |                         |                   |
| (amounts in thousands)               |                     |                                    |  |                         |                   |
|                                      | Revenue             | Payroll and<br>Related<br>Expenses | Selling, General<br>and Admin.<br>Expenses | Restructuring<br>Charge | EBITDA            |
| ARM                                  | \$ 804,484          | \$ 377,314                         | \$ 336,983                                 | \$ 8,775                | \$ 81,412         |
| CRM                                  | 190,400             | 145,892                            | 35,450                                     | 846                     | 8,212             |
| Portfolio Management                 | 144,719             | 5,726                              | 91,493                                     | -                       | 47,500            |
| Eliminations                         | (87,320)            | -                                  | (87,320)                                   | -                       | -                 |
| <b>Total</b>                         | <b>\$ 1,052,283</b> | <b>\$ 528,932</b>                  | <b>\$ 376,606</b>                          | <b>\$ 9,621</b>         | <b>\$ 137,124</b> |

| Predecessor                          |                   |                                    |  |                   |
|--------------------------------------|-------------------|------------------------------------|--|-------------------|
| For the Year Ended December 31, 2004 |                   |                                    |  |                   |
| (amounts in thousands)               |                   |                                    |  |                   |
|                                      | Revenue           | Payroll and<br>Related<br>Expenses | Selling, General<br>and Admin.<br>Expenses | EBITDA            |
| ARM                                  | \$ 746,201        | \$ 357,101                         | \$ 295,359                                 | \$ 93,741         |
| CRM                                  | 159,024           | 113,719                            | 26,658                                     | 18,647            |
| Portfolio Management                 | 98,023            | 2,095                              | 65,621                                     | 30,307            |
| Eliminations                         | (63,451)          | -                                  | (63,451)                                   | -                 |
| <b>Total</b>                         | <b>\$ 939,797</b> | <b>\$ 472,915</b>                  | <b>\$ 324,187</b>                          | <b>\$ 142,695</b> |

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**20. Related Party Transactions:**

Prior to March 2004, the Company used an airplane that was partly owned by Michael J. Barrist, President, and Chief Executive Officer of NCO. The Company reimbursed Mr. Barrist \$209,000 for the use of the plane. In February 2004, the Company took an assignment of rights held by Mr. Barrist to purchase an interest in a new airplane. For the period from January 1, 2006 through November 15, 2006, Mr. Barrist reimbursed the Company \$203,000. For the years ended December 31, 2005 and 2004, Mr. Barrist reimbursed the Company \$100,000 and \$120,000, respectively, for his personal use of the aircraft.

In connection with the Transaction, the Company paid OEP a transaction fee of \$18.8 million, which is included in the \$68.5 million total Transaction costs (note 4). The Company has agreed to pay OEP a management fee of \$3.0 million per year, plus reimbursement of expenses, for management, advice and related services. During the period from July 13, 2006 through December 31, 2006, the Company accrued \$375,000 relating to management fees.

OEP is an affiliate of JPMorgan Chase (“JPM”), and JPM is a client of the Company. For the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, the Company received fees for providing services to JPM of \$5.9 million and \$965,000, respectively. For the years ended December 31, 2005 and 2004, the Company received fees for providing services to JPM of \$7.9 million and \$13.4 million, respectively. At December 31, 2006, the Company had accounts receivable of \$177,000 due from JPM. Additionally, affiliates of Citigroup are co-investors of the Company, and Citigroup is a client of the Company. For the periods from January 1, 2006 through November 15, 2006 and July 13, 2006 through December 31, 2006, the Company received fees for providing services to Citigroup of \$28.5 million and \$3.9 million, respectively. For the years ended December 31, 2005 and 2004, the Company received fees for providing services to Citigroup of \$31.9 million and \$29.7 million, respectively. At December 31, 2006, the Company had accounts receivable of \$2.0 million due from Citigroup.

**21. Recently Issued and Proposed Accounting Pronouncements:**

*FASB Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment”:*

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment” (“SFAS 123R”), which requires that the cost of all share-based payments to employees, including stock option grants, be recognized in the financial statements based on their fair values. The standard will apply to newly granted awards and previously granted awards that are not fully vested on the date of adoption. The Company adopted the standard on January 1, 2006 using the modified prospective method.

Effective December 29, 2005, the Company accelerated the vesting of outstanding unvested stock options that have an exercise price equal to or greater than \$17.25 per share (“Eligible Options”). Any shares received upon the exercise of Eligible Options are restricted and may not be sold prior to the date on which the Eligible Options would have been exercisable under the original terms. As a result of the acceleration, options to purchase 944,308 shares of the Company’s common stock became immediately exercisable. All other terms and conditions applicable to the Eligible Options remain unchanged. All terms and conditions of all options that are not Eligible Options remain unchanged. The purpose of the acceleration was to eliminate future compensation expense associated with the Eligible Options of approximately \$3.9 million, net of taxes, that would have otherwise been recognized upon the Company’s adoption of SFAS 123R on January 1, 2006.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**21. Recently Issued and Proposed Accounting Pronouncements (continued):**

*FASB Statement of Financial Accounting Standards No. 154, “Accounting Changes and Error Corrections – a replacement of APB Opinion No. 20 and FASB Statement No. 3”:*

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, “Accounting Changes and Error Corrections – a replacement of APB Opinion No. 20 and FASB Statement No. 3” (“SFAS 154”), which replaces APB Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS 154 applies to all voluntary changes in accounting principles. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. It does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of SFAS 154. The Company adopted SFAS 154 on January 1, 2006, and it did not have a material impact on its financial statements.

*FASB Statement of Financial Accounting Standards No. 155, “Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140”:*

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, “Accounting for Certain Hybrid Financial Instruments” (“SFAS 155”). This statement amends SFAS No. 133 “Accounting for Derivative Instruments and Hedging Activities” and SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.” SFAS 155 permits fair value remeasurement for hybrid financial instruments that contain embedded derivatives that would require separate accounting. In addition, the statement establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain embedded derivatives. SFAS 155 is effective for all financial instruments acquired or issued beginning after an entity’s fiscal year beginning on September 15, 2006 with earlier adoption permitted. The Company adopted SFAS 155 on November 16, 2006, and it did not have a material impact on its financial statements.

*FASB Statement of Financial Accounting Standards No. 156, “Accounting for Servicing of Financial Assets – an Amendment of FASB Statement No. 140”:*

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, “Accounting for Servicing of Financial Assets – an Amendment of FASB Statement No. 140” (“SFAS 156”). This statement amends SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.” SFAS 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable, and provides two methods for the subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. This statement is effective for fiscal years beginning after September 15, 2006. Management does not believe the adoption of SFAS 156 will have a material impact on the Company’s financial statements.

*FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes”:*

In July 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”), which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position, be recognized in the financial statements. The provisions of FIN 48 are effective as of the beginning of the Company’s 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. Management has not completed its review and assessment of the impact of the adoption of FIN 48.

**NCO GROUP, INC.**  
**Notes to Consolidated Financial Statements (continued)**

**21. Recently Issued and Proposed Accounting Pronouncements (continued):**

*FASB Statement of Financial Accounting Standards No. 157, "Fair Value Measurements":*

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157"). This statement defines fair value and provides guidance for measuring assets and liabilities at fair value. This statement also expands the disclosure requirements about the use of fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. Management has not completed its review and assessment of the impact of the adoption of SFAS 157.

**22. Subsequent Events:**

In January 2007, the Company acquired Statewide Mercantile Services, a company specializing in accounts receivable management services in Melbourne, Australia, for approximately \$2.0 million.