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FINANCE

Debt Collection Puts On A Suit

As consumer loans hit an all-time high, the industry gets more sophisticated

Debt collectors are going corporate. Although the \$15 billion-a-year industry still conjures up images of no-neck goons pounding on people's doors, collection agencies are cleaning up their act and tapping Wall Street for money. In the third quarter alone, private-equity firms, venture capitalists, and others invested a record \$1.6 billion in the business, almost as much as in all of last year. Six firms are now publicly traded, and two made secondary share offerings this year. Instead of guessing which deadbeats might pony up, firms are using sophisticated software to spot the best bets before buying bundles of bad debts from banks and credit-card companies.

What has captured Wall Street's attention is the mountain of debt that Americans keep piling up. In the past five years, consumer loans have jumped 25%, to a total of \$2.1 trillion. The bankruptcy reform that took effect on Oct. 17 promises more business for collection agencies because the new law makes it much harder for many people to dump their debts by going to court. "It won't be as easy to absolve your debts with one stroke of a judge's pen," says James O'Brien, a financial services analyst at Brean Murray & Co.

Those trends are attracting big names into the business. In September, one of Citigroup's () venture-capital funds bought a controlling stake in Receivable Management Services Corp., a Bethlehem (Pa.) outfit specializing in business debts, and student lender Sallie Mae () bought a company that buys bad home loans. The dealmaking is set to continue: There are still 5,215 collection agencies in the U.S. with an average of just 19 collectors each, according to the ACA International, a trade group. "The industry is large, fragmented, profitable, and growing," says Michael Ginsberg, whose boutique investment bank, Kaulkin Ginsberg Co., follows the sector.

The new players are changing how the industry operates. No longer do the top agencies merely collect past-due debts and get a percentage of what's recovered. These days they buy large portfolios written off by lenders, taking on the risk of collection themselves. A portfolio might sell for just 2 cents on the dollar but yield as much as 6 cents. The value of all bad-debt purchases has more than doubled since 2000, to \$77 billion last year, according to industry trade publication *The Nilson Report*.

LEAVING DODGE CITY

The industry is using the latest database technology to handle this fast growth. To avoid less profitable accounts, San Diego's Encore Capital Group Inc. () looks at historical data on collections to analyze the debt portfolios before it buys them. If certain people are "making payments on their mortgage and auto loans but not on their credit cards," explains Encore CEO J. Brandon Black, "they are much more creditworthy than a consumer who has had a home foreclosure."

Of course, a chunk of the industry still operates by Dodge City rules. In July the Federal Trade Commission won a \$10.2 million judgment against the principals of a now-defunct Secaucus (N.J.) company called National Check Control. It accused the firm of making repeated phone calls, threatening consumers, and using obscene language. Last year the agency shut down a Rockford (Ill.) outfit, Capital Acquisitions & Management Corp., after receiving more than 2,000 complaints of harassment and deceptive practices.

Although the industry is going corporate, it continues to be plagued by high turnover. Asset Acceptance Capital Corp. () in Warren, Mich., the largest of the publicly traded players, narrowly missed its earnings expectations when it reported third-quarter results on Nov. 1. The company blamed the shortfall on its high employee turnover rate -- 85% a year. Collecting debts may be lucrative -- but it's still not a whole lot of fun.

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