

Collection Agencies Booming

By Shasha Dai

6/1/2006 -- As interest rates rise, more people could default on their debt - to the glee of debt-collection agencies.

Private equity firms - which know a thing or two about debt themselves - have been quick to seize the opportunity, buying collection firms at a rapid clip over the last few months. Firms like American Capital Strategies Ltd., Brazos Private Equity Partners LLC, Guggenheim Partners LLC and KRG Capital Partners LLC have all invested in this sector lately.

The industry, which serves commercial and state clients, is powered by ballooning debt totals and rising interest rates. Outstanding government, business and personal debt in the U.S. grew to \$26.4 trillion at the end of 2005 from \$24.1 trillion a year earlier, according to the Federal Reserve.

The government sector in particular is promising more business for collection agencies, according to Michael Ginsberg, chief executive of Kaulkin Ginsberg, an investment banking firm that specializes in the industry. "The IRS is potentially the single largest source for collection," he said. A 2004 revision to tax law allows the IRS to hire private collection agencies to collect back taxes, putting an estimated \$120 billion-plus up for grabs. Government contracts are typically multi-year and renewable.

There are plenty of opportunities for add-on deals, as well. The industry is highly fragmented, with about 95% of the 6,500 collection agencies in the U.S. having revenue of less than \$5 million, according to Brian Greenberg, a managing director specializing in the debt collection sector at advisory firm Milestone Advisors LLC. The business is easily scalable, as merging companies can combine their client accounts while sharing back-office functions, Greenberg said.

However, investing in the sector carries risks. Firms could run into trouble if there is a mismatch between the timing of collection and repayment of their own debt associated with their buyouts. Moreover, creditors are increasingly signing contracts with multiple collection agencies at once, in part to encourage competition and keep rates down, thus squeezing the agencies' profit margins.

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