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Bad Debt Can Be Good Business

By NJBIZ Staff, Jim McConville - 3/12/2007

ENGLEWOOD CLIFFS - Bad debt HAS become an attractive business for New Jersey companies that can buy up large chunks of debt for a song and then squeeze a sizable profit out of it.

Once the domain of banks and credit card companies, debt collection has evolved into its own industry of professional companies that buy credit card accounts from the original lenders for pennies on the dollar.

Presently, there are an estimated 6,000 debt collection companies in the country, according to Kaulkin Ginsberg, a Bethesda, Md.-based market research firm. However, most are small private operations. The handful of larger, publicly traded ones include Englewood Cliffs-based Asta Funding Inc., and Newark-based IDT Corp., which set up a separate debt collection group last year.

"Let's be honest, credit collection is a tough business," says Steven C. Delaney, managing director of research for Flagstone Securities in New York. "If you are Bank of America or Capital One, do you really want to get your name out there and have to swing tough to get your money back?"

Today, says Delaney, banks try a round or two of collections and then charge off the accounts and sell them to a collector for 3 cents to 5 cents on the dollar. "To banks and credit card companies, it's a cost of doing business," he says. "They write them off and move on."

Nationally, Americans have piled up more than \$2.4 trillion in consumer credit, according to data compiled by the Federal Reserve Bank of Philadelphia (see chart). This total is exclusive of consumer mortgages.

"Debt is a very healthy business. Americans are awash in debt," says Audrey Snell, partner and senior research analyst for specialty financials and banks for New York-based ThinkEquity Partners.

According to Kaulkin Ginsberg, debt collectors pulled in more than \$115 billion in face value of delinquent debt in 2005, the latest year for which such data is available.

"The debt collection business today is a very stable and profitable business and we think that it's going to lead to new markets," says Steve Brown, co-CEO of IDT Capital and senior vice president of corporate development for IDT Corp. "The [debt] industry is on the cusp of a lot of change. There's a whole bunch of debt that we think is going to be entering the market that was not available to be purchased before."

The granddaddy of New Jersey's debt collection businesses is Asta Funding Inc., started in 1964 by Chairman Arthur Stern, who bought assets from defunct credit unions.

Last January, Asta set a national record when it agreed to pay an estimated \$300 million for a debt portfolio with a face value of \$6.9 billion. The seller was Great Seneca Financial Corp., a Rockville, Md.-based debt collection company. In addition to the \$300 million that Asta agreed to pay front, the company will kick in 20 percent of the net payments it collects after recovering 150 percent of its purchase price.

"Portfolio purchases of this magnitude are rarely seen in this marketplace, but our business model allows us to make an acquisition of this size almost seamlessly," says Asta President and CEO Gary Stern, son of the company founder.

Mark Russell, research director for Kaulkin Ginsberg, says prices for debt portfolios "have gone through the roof. It's very challenging nowadays to start a debt purchasing operation from scratch within

that marketplace."

For its fiscal first quarter that ended Dec. 31, Asta earned \$11.3 million on revenue of \$25.6 million. That

represented increases of 22 percent in earnings and 27 percent in revenue when compared with the year-ago quarter.

Asta's net cash collections from consumer receivables acquired for collection totaled \$58.9 million for the quarter, up 28 percent from last year.

"Their [Asta] returns on invested capital are 25 to 30 percent, so I would say that they are doing quite well," says Snell.

Besides purchasing delinquent receivables, debt collectors use credit scoring—a statistical estimate of a person's credit-worthiness— and other database technologies to locate first-time delinquent customers with readily available assets.

IDT, which built its multi-million dollar empire selling discounted long distance service and prepaid calling cards, is the most recent New Jersey company to throw its hat into the debt ring.

The company entered the debt collection business last year when it opened a small call-center business in Israel.

"The operation of a call center isn't significantly different from setting up the same kind of structure to operate debt collection," says Brown. "We've learned that debt collection is something that we can handle because of our experience in the call-center business."

In January 2006, the company's

IDT Carmel subsidiary joined forces with First Financial Portfolio Management, an Atlanta-based debt collector, to purchase \$121 million in credit card debt from an undisclosed national commercial bank.

This followed IDT Carmel's purchase last June of Big Ten Management, a small Minnesota-based debt-collection company, for an undisclosed sum.

Since its launch in 2005, IDT Carmel has bought an estimated \$296 million in receivables owed to other companies. "If you work this debt properly, your [annual] return after taking out what you would have gotten in interest is about 25 to 30 percent," IDT Chairman Howard Jonas told a roomful of financial analysts in January.

"If we could get a couple more [large commercial banks] to sell to us, then we could conceivably spin this off as a public entity," Jonas added. "We can have a billion dollars worth of value if we choose to do that."

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