



DJ TALES OF THE TAPE: Debt Collectors Aim To Cash In

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NEW YORK (Dow Jones)--With defaulted consumer debt plentiful and cheap, some collection firms are betting that today's charge-offs are tomorrow's cash.

At least four publicly traded collectors--Portfolio Recovery Associates Inc. (PRAA), Asset Acceptance Capital Corp. (AACC), Encore Capital Group Inc. (ECPG) and Asta Funding Inc. (ASFI)--each acquired more charged-off debt in the most recent quarter than in the same period last year.

Some are buying two or three times as much bad debt as they used to. Little wonder: It costs about half as much as it did two years ago, at the market's peak, according to some industry estimates. Huge charge-offs by credit-card companies are one big driver. As in other markets, there are also fewer buyers, after a partial retreat by hedge funds and private equity firms.

Collection firms don't need an immediate economic recovery to make money. Some recoup it over horizons of half a decade or longer. Buying debt for pennies on the dollar, they can profit even if they just collect a little.

The strong performance of debt-collection stocks this year certainly suggests strong belief in the "promise," if you can call it that, of bad debt.

Shares of Portfolio Recovery Associates have more than doubled since their March lows. Asset Acceptance's stock is also nearly double its low. Encore has jumped about sixfold from its own, in anticipation of stronger revenues. Asta Funding is also well off its March low, despite a recent dip.

But not all industry observers think the promise of 2009's "vintage," as the industry calls bad debt, is all it's cracked up to be.

There is risk of increased government scrutiny. The federal consumer watchdog agency under discussion in Washington might look closely at collection firms if it's created. The plan is currently in legislative limbo.

"One of the reasons I'm more hesitant to recommend names in this industry is that political regulatory issues can change across states, and are difficult to anticipate," Sameer Gokhale, analyst at Keefe, Bruyette Woods & Co., said.

Another issue: High returns on this year's debt assumes consumers won't be as pinched in the next few years, which isn't certain.

"Debt buyers may in fact realize better returns from purchasing portfolios today, if in fact we don't end up entering a double-dip recession," Mark Russell, a director and debt-buying expert at Kaulkin Ginsberg, said. It depends on the price paid for the debt, he said.

But if bad debt's price keeps falling, even a much longer recession could be surmountable.

Asset Acceptance, Warren, Mich., was able to snap up \$1.6 billion in bad debt for \$37.2 million in the third quarter, compared with \$719 million for a similar price last year. Rion Needs, Asset Acceptance's president and chief executive, said in an interview that the company plans to keep purchasing heavily into 2010.

Even as they snap up new debt at low prices, some companies are also writing down older, more expensive debt that has lost value. This week, Asta Funding's stock slumped when the company said it recorded fourth-quarter impairments of \$137 million to reflect its holdings' lower value. But Asta also said it spent three times as much buying up cheaper debt this quarter compared with last year.

The supply seems likely to grow. Just this week, several major credit-card issuers reported higher delinquencies for the month of November, which might portend further price drops.

Many firms have already staffed up, since collecting in a recession is more costly and time-consuming. The methods employed can range from more gracious payment plans to peskier phone calls and mail or even suing debtors more frequently.

The effort to buy more bad debt "certainly suggests that 2010 should be an extremely good year for Asset Acceptance," said David Nierenberg, whose Nierenberg Investment Management Inc. is the one of the largest shareholders in Asset Acceptance.

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