

Kaulkin Ginsberg sends *INSIGHT* each month to provide you and others in the Accounts Receivable Management (ARM) industry with valuable content designed to assist you in making strategic business decisions.

We hope you enjoy this issue. Comments are always welcome at hq@kaulkin.com.

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Download our recent article: "The State of the Industry: What's Next for ARM?" online at www.kaulkin.com/KGC_StateOfARM_Jan08.pdf

The Kaulkin Ginsberg *Bulletin* has been in distribution for over six years. In that time, accounts receivable management (ARM) has changed substantially. What started out as a newsletter to inform select clients and individuals about key M&A transactions has expanded to provide substantive information on a number of trends that impact ARM. In short, it's more about *Insight*. Hence, we're changing the name. As always, your questions, comments – and your own insights – are welcome.

There has been a lot of change at Kaulkin Ginsberg in the past year. We re-launched our media website (formerly CollectionIndustry.com) as insideARM.com, and it now provides expanded coverage of the most significant creditor markets. We also began a new Analyst Group at Kaulkin Media to support this initiative. Our industry experts focus on providing a deeper level of analysis for ARM professionals.

Our Strategic Advisory team has also grown. For example, Director David Lavine has led the expansion of our litigation support practice, and we've already successfully supplied court documents and expert witness

testimony for clients in a number of U.S. District Court cases.

Our M&A team completed a number of signature transactions in the industry last year, including the sale of Great Seneca Financial Corp's \$6.9 billion debt portfolio to Asta Funding; the sale of Mutual Hospital Services, Inc. to Kadent Corporation; Teleperformance's acquisition of AllianceOne; and sale of the non-legal assets of Wolpoff & Abramson to Axiant LLC.

Although we see challenges ahead for ARM in 2008, as detailed in our recent article "[The State of the Industry: What's Next for ARM?](#)" we also know that this industry is characterized by competitive, driven, and resourceful professionals. We will continue to do all we can to provide the insight, access, and information you need to succeed. Please enjoy this issue of *Insight* and I wish you a prosperous 2008!



Mike Ginsberg
President & CEO



The Credit Crunch and ARM: Predictions for 2008

By Paul Legrady
Director, Kaulkin Ginsberg

Happy New Year 2008. Buckle your seatbelts! I am beginning the year with nine predictions. All forecasts explain how the credit crunch that roiled the U.S. economy in 2007 will hit the ARM industry even harder in 2008. The results bring significant opportunities for some, disproportionate risk for many, and another year of intrigue for all executives in this increasingly complex industry.

1. The Economy Slips into Recession
Continued declines on the housing market and economic pressures on the American consumer will cause the economy to dip into a mild recession by the second half of the year. Recession is defined here as two consecutive quarters of negative economic growth. Consumer spending – which comprises roughly two thirds of U.S. economic output – will wane, unemployment will increase moderately, and the economy will decline for two consecutive quarters for the first time since the beginning of 1991.

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The Credit Crunch and ARM: Predictions for 2008 (*Continued*)*(Continued from page 1)***2. Recoveries Become More Challenging**

During periods of economic growth, recoveries are easier while demand for receivables management services decreases; alternatively, during periods of negative economic growth, recoveries are more challenging as demand for the services of ARM companies increases. These trends will make collections harder for the entire ARM industry this year. All other things being equal, a dollar may be 5 to 10 percent harder to recover from U.S. consumers in 2008 than it has been in recent years.

3. Credit Issuers Turn More to Debt Sales

By selling portfolios of delinquent debt, credit issuers realize upfront cash flows that would have been recovered over time by contingency agencies. As the economy slows and publicly traded credit issuers struggle to meet earnings expectations, debt portfolios will be sold in increasing numbers and in larger sizes, providing purchasing opportunities as well as negotiating leverage to the largest purchasers of delinquent debt.

4. Prices of Debt Portfolios Wane on Primary and Secondary Markets

The coming flood of debt portfolios, from credit card issuers to telecommunications suppliers to hospital companies, will finally tilt the balance of supply and demand in the favor of debt buyers, and prices will drop accordingly. This will take place not only on the primary market, but on the secondary market as well, as brokers and resellers are already passing more supply onto smaller buyers.

5. Contingency Agencies Lose Clients

In a period of economic growth, demand for the services of contingency agencies and debt buyers can increase hand in hand. In a period of negative economic growth, contingency agencies, at least those serving the largest credit issuers, will lose some business to debt buyers. Simply put, debt cannot be placed when it has already been sold, and this will strongly impact the financial performance of some collection agencies in the coming year. The good news – top-performing agencies should pick up lost business from debt buyers that place with contingency agencies.

6. Contingency Agencies Experience Declines in Fees

The sale of debt portfolios will increase competition among contingency agencies for the contingency work that remains, and this will lead to lower fees. Contingency agencies may also work for debt buyers. However, these contracts will also be signed at lower fees. It remains to be

seen how low fees can go before the owners of some contingency agencies decide that clients can no longer be serviced profitably.

7. Fewer Home Equity Lines of Credit

As housing prices were increasing, collection agencies and debt buying companies encouraged consumers to take out HELOCs or transfer debt to newer credit instruments. As housing prices are decreasing, fewer equity loans are available, particularly as regulatory reform makes less creative mortgage instruments available to consumers. As HELOCs become less available, this repayment option will be less available to many collection agencies.

8. M&A Activity Declines

Kaulkin Ginsberg has yet to see a turn in the cycle for mergers and acquisitions. Deals are still closing at competitive prices for strong companies. At the same time, the M&A market is cyclical. When companies see declines in revenues and profits, owners are less likely to sell and most buyers are less likely to acquire. Economic pressures caused by the credit crunch should cause the M&A market to subside a bit in 2008.

9. Better Financial Performance in Smaller Pockets of ARM Industry

The market forces underlying these predictions will disproportionately affect companies that compete in more crowded parts of the ARM industry, where services offered are more homogenous and more likely to involve competition on the basis of price. In smaller pockets of the industry – involving smaller geographic locations, or alternative types of consumer debt, or better differentiated services – companies will be better able to maintain or even improve financial performance.

These forecasts in whole are rather gloomy. What can be done to make 2008 a better year for companies in the ARM industry than 2007?

The ARM companies that maintain or improve financial performance during this more challenging economic climate will be those that focus on their own competitive advantages – whether they are related to hiring processes, technology systems, collection methodologies, etc. By focusing on what makes your company unique in this competitive industry, you can build on your company's strengths and equip yourself for what will surely be a more challenging business climate to come.

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2007 M&A in the ARM Industry Still Active But Market Turn May Be Ahead

By Mark Russell
Director, Kaulkin Ginsberg

Merger and acquisition activity remained high in the accounts receivable management industry (ARM) in 2007, but economic forces and market conditions may slow down activity in 2008.

We calculate the total deal value in 2007 at \$1.65 billion from 48 completed transactions. The year was characterized by fewer transactions involving comparatively larger deal values, bringing total value on par with prior years. In 2006 there were 72 deals at \$3.10 billion in total deal value, but this was largely due to three private equity-led transactions which represented roughly two-thirds of the total value for the year.*

Significant announced deals of 2007 include:

- The [purchase of 37 percent of the equity](#) of Sherman Financial Corp. by its management team for \$518.8 million.
- [West Corporation's purchase](#) of one of the largest privately-owned ARM firms, Omnium Worldwide, for \$150 million.
- [AllianceOne was acquired by France-based Teleperformance](#), enabling the global BPO corporation to gain a foothold in the U.S. ARM market.
- [NCO Group announced a \\$325 million deal to acquire Outsourcing Solutions, Inc.](#), combining two of the largest ARM firms in North America. This transaction is expected to close in the first quarter of '08 and was not calculated in 2007 year-end results.

Looking to the year ahead, financial and strategic buyers are still looking for acquisition opportunities in the ARM industry, but some may be more conservative in evaluating acquisition targets, particularly if liquidation results in 2008 are below expectations. The fourth quarter of 2007 generated less than anticipated liquidation results by some collection agencies and debt purchasing companies, causing some acquirers to become uncertain as to where the market is headed. Deals will still get done in 2008, but some of them may involve a combination of cash and structure in order to bridge the gap between buyers' and sellers' value expectations.

The current credit crunch impacts ARM from both ends – it makes it more difficult for consumers to repay their overdue accounts, and it is forcing business changes among creditor industries that employ ARM firms. For example, fewer mortgage products mean consumers have less access to loans to consolidate debt, but it also means

less business for small and mid-sized banks, which may merge in order to boost their branch networks and retain profitability. Mergers among this segment will trickle down to mean fewer clients for ARM firms.

I believe the lower liquidation levels experienced in Q4 of 2007 were primarily driven by consumers concerned about the economy and how it will impact their financial situation. We have been inundated over the past few months with news about the economy heading into a recession and increases in the unemployment rate; couple this with higher utility costs and mortgage payments, and it's not surprising that consumers are behaving as if we are already in a recession.

During a recession, major credit issuers like credit card lenders typically increase the volume of placement outsourcing to collection agencies and debt buyers, but it becomes harder for the debt purchasing companies and collection agencies to liquidate the debts. This can potentially flatline or reduce the level of collections and profitability of ARM firms in the short term. Lower profits can cause buyers to change the way they structure deals, prompting business owners to either accept some deal structure in a transaction or defer selling.

However, companies and government entities are outsourcing increasing volumes of charged-off accounts, the declining pricing on portfolio sales will stimulate more debt purchasing activity, and the U.S. Department of Education student loan collection contract is renewing later in the year. With this in mind, 2008 has the makings of another decent year for M&A if the unemployment rate does not rise much above five percent and the economy doesn't head into a deep recession. This would be especially true for "recession-resistant" firms – high-performing companies and niche players within growth markets in the ARM industry. The good news is that the debt collection industry tends to lag behind most major economic indicators, and comes out of a recession a lot quicker than other large markets.

*Major 2006 transactions were the management-led buyout of NCO Group, and the recapitalizations of West Corporation and Cabot Financial Group.

Mark Russell manages M&A transactions for Kaulkin Ginsberg. To confidentially discuss your business interests, please contact Mark Russell at 240-499-3804, or by email at mark@kaulkin.com.



Valuation Alert for Debt Buyers

By David Lavine, CPA
Director, Kaulkin Ginsberg

A small accounting change by the Financial Accounting Standards Board (FASB) will have a big impact – especially for debt buyers looking to secure financing to purchase new inventory.

Starting this fiscal year, accounting standard “FASB 159” allows a company to report certain assets at fair market value rather than at cost. If your company purchases debt, it clearly meets the 'substance over form' criteria of the FASB.

This means that you can present the market value of the portfolios you own under management, thus increasing the equity amount of the business. This reflects a much clearer picture of the true equity of the enterprise. Balance sheet management can now be based on market value, as it should be.

This can be enormously useful when valuing your enterprise to determine equity for financing, for dispute resolution, or in preparation for a company sale. We are already assisting one portfolio debt buyer with a valuation of their accounts to provide their accountants for their FY 2007 financial statements. I strongly suggest that everyone with purchased debt explore this option with their professional advisor.

Most debt buyers have no idea that this option is available to them. Spread the word!

David Lavine is the leading valuation expert in the credit and collection industry. He provides business valuation, litigation support, and other advisory services to select clients. For a confidential discussion of your needs, contact David at 240-499- 3812 or email david@kaulkin.com.



Upcoming Events

To help you plan ahead, Kaulkin Media mails out a Calendar of Events for the industry four times per year. If you aren't on our mailing list but would like to be, please send an email to hq@kaulkin.com with your current mailing address. You can also review a complete listing online at www.insideARM.com/events.

If you would like to meet with us in person at one of these upcoming shows, please email hq@kaulkin.com to schedule a confidential discussion.

[DBA International World Series of Debt Buying Conference](#)

February 5-7, Las Vegas, NV

Several members of the strategic advisory team will be on hand at this annual industry conference, including Mark Russell, Paul Legrady, and Jamie Welsh.

[12th Annual National Collections & Credit Risk Conference](#)

March 5-7, New Orleans, LA

Let us know if you would like to meet a member of our team at this show.

About Kaulkin Ginsberg

We've been providing ARM professionals, owners, and investors worldwide with value-add advice, expertise, and information to make well-informed decisions for 16 years. We offer a full array of strategic advisory services to support you through almost every stage of your company's lifecycle, from strategic analysis, to growth and exit strategies – including M&A. The Kaulkin Ginsberg family of companies also includes Kaulkin Media, the leader in providing timely news, analysis and information on the recovery of debt in all industries and publisher of the most

popular sources of industry information such as [insideARM.com](http://www.insideARM.com)TM (formerly CollectionIndustry.com) and *The ARM Insider*TM. Kaulkin Information Systems creates secure and affordable workflow, document, and business process management technologies (www.kistrack.com). Read more about Kaulkin Ginsberg at www.kaulkin.com.

What can we do for you?

To discuss your business needs in confidence, send an email to hq@kaulkin.com or call us at 301.907.0840.