



The Kaulkin Ginsberg *Bulletin* is sent each month to provide you and others in the Accounts Receivable Management (ARM) industry with valuable insight, access, and information. Each issue contains actionable 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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We're at nearly \$1 billion! That's our estimated total value of all the merger and acquisition transactions that have happened in the ARM industry in the first half of 2007. Despite talk of a cool-down in the mainstream business press, there is still active interest in ARM from strategic, financial, and industry buyers. In this edition of the Bulletin, we take a closer look at this.

As you look for ways to grow your business, we've included an article from Director Paul Legrady on developments that will shape the future, from our *Kaulkin Report*, 7th edition. Also, Gary Zelamsky provides thoughtful guidelines for retaining your good employees and reducing turnover.

I'm pleased to welcome a new contributor to the *Bulletin*. Industry reporter Burney Simpson has joined our growing editorial staff on insideARM.com. If you aren't already a registered member, I encourage

you to [sign up](#) to read our expanded coverage of many industry segments, including credit card and banking markets.

Read on as Burney reviews how investment analysts have been assessing publicly-traded debt purchasing companies.

If you have any questions about how current trends or changes might affect your business, or would like to confidentially discuss your particular interests, do not hesitate to call me or a member of our advisory team. We look forward to speaking with you.

Mike Ginsberg
President & CEO



2007 M&A Activity ARM Industry Nears \$1 Billion

By Michael Lamm, Associate

Increased activity noted among mid-sized firms

Merger and acquisition activity in the ARM industry has maintained a fast pace through the second quarter, exceeding last year's deal value year-to-date. There have been 25 transactions with a total estimated deal value of roughly \$910 million this year.

The first two quarters of last year saw 28 deals with an estimated total deal value of \$790 million, and 2006 went on to set a new industry record of \$3.1 billion for the year. However, it wasn't until the

fourth quarter of last year that the new deal value record was set, thanks to two major private equity transactions: the privatizations of NCO Group and West Corporation. We estimate the ARM deal value of these transactions at \$1.625 billion. This year, we predicted that more strategic and financial buyers would enter the ARM industry, or add-on to their current investments, and that is exactly what is taking place.

The largest transaction of the second quarter occurred in May, when West Corporation purchased Omnium Worldwide, for \$150 million.

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2007 M&A Activity ARM Industry Nears \$1 Billion (*Continued*)*(Continued from page 1)*

Other significant transactions included the purchase of a 25 percent stake in Encore Capital Group (NASDAQ: ECPG) by investors from J.C. Flowers & Co. and FPK Capital; the \$64 million purchase of ARM agency Creditors Interchange Receivables Management, LLC (Creditors Interchange), by Debt Resolve, Inc. (AMEX: DRV); and the \$55 million purchase of Nationwide Credit Inc., Atlanta, Ga., by Ocwen Financial (NYSE:OCN).

This is still a very active M&A market. Given our knowledge of activity in the pipeline along with several pending deals, we expect the current pace of transactions to continue throughout the rest of the year.

Michael Lamm manages M&A transactions and valuations for Kaulkin Ginsberg. Michael can be reached at 301-907-0840 ext. 119 or at mlamm@kaulkin.com.



The Future of Receivables Management

By Paul Legrady, Director

In August, Kaulkin Ginsberg will release the 7th Edition of *The Kaulkin Report*, subtitled "The Future of Receivables Management." This biennial publication has long been regarded as the authoritative review of the ARM industry. It is no crystal ball, but it takes positions on the forthcoming direction of the industry and should help owners, managers, and investors plan for the future. An executive summary of the publication will be available free of charge on insideARM.com, and the full publication will be available for purchase in the insideARM.com bookstore.

This publication is more ambitious and potentially more controversial than its predecessors. Prior editions of this publication offered descriptions of the industry, reviewed recent events, and described notable trends to date. This publication goes much further. As its subtitle reflects, our goal here is not only to describe the industry as it currently exists: we make some informed predictions about how the industry will evolve in the coming years.

These predictions are based on a review of eight constituencies that comprise the ARM industry: consumers, creditors, regulators, contingency collectors, debt buyers, first-party collectors, collection law firms, and buyers and sellers of companies. These constituencies will become more diverse in coming years as consumer credit is further extended and business models become more fluid. In many cases, these developments will be well rewarded. Receivables management, at least for certain credit grantors and certain service providers, will remain a highly profitable endeavor.

At the same time, creditors and service providers are facing real challenges, and these should increase in the coming years. Slower economic growth, data security requirements, consumer litigation, less collectible paper,

pricing pressure, the slowing housing market, and other factors will increase the risk of doing business in the ARM industry over the next five years. The most successful ARM companies will develop business systems and processes that best mitigate these risks.

For example, the mortgage delinquency rate on one-to-four-unit residential properties was 4.84 percent of all loans outstanding at the end of the first quarter of 2007, up from 4.41 percent a year earlier, according to the Mortgage Bankers Association (MBA). All subprime mortgage delinquencies stood at 13.77 percent, more than two and a half times the rate increase for all loans in the same period. In June 2007, the MBA indicated that the number of U.S. mortgages going into foreclosure in the first quarter of 2007 was the highest percentage in almost 30 years. As subprime mortgage delinquencies and foreclosures increase, borrowers have less ability to leverage home equity to repay more expensive debts, and recoveries in all sectors of the ARM industry will be affected.

Given these risks and rewards, success in the ARM industry will be based largely on how companies choose their competitive niches. As years progress, the effects of these choices will become apparent to competitors, clients, consumers, and regulators alike.

We look forward to sharing these forecasts with you, and, of course, working with you to create the real future of receivables management.

Paul provides advisory services to select clients, including creditors, receivables management companies, service providers, investors, and prospective acquirers. Contact Paul at 301-907-0840 ext. 104, or at plegrady@kaulkin.com.



Six Steps to Retaining Your Best Employees

By Gary Zelamsky
 Founding Partner, Executive Alliance

Does it seem that no matter what you've done, your company still has high turnover? Are you resigned to running on the treadmill, constantly starting a new group of collectors, account executives, or other key employees? Do you feel like too many employees are leaving just when they finally learned the right way to do things?

Losing a good employee is costly. It can cause morale problems for those who remain. Resulting staff shortages cause operational problems and missed deadlines for customer projects. It's expensive to hire and train new staff, and it takes a long time for new employees to reach full productivity. These are some of the reasons why you may want to place greater emphasis on retaining your good employees.

While many growing businesses have these problems, you don't have to spend all your time dealing with these issues. There are steps that you can take that will minimize turnover of good employees.

First, please realize that it's not just about money. Compensation is only one factor that may influence employees to stay or leave. While you want to make sure that you are competitive in the marketplace, you don't need to be the highest-paying organization in order to have loyal staff. Here some other areas to think about.

Track turnover

What gets measured gets done. I suggest dividing the number of annual departures by the average number of employees. Unless you have very wide fluctuations, the average number of employees is approximately the number at the beginning of the year plus the number at year-end, divided by two. To be more accurate you can also count employees on a monthly basis. However you compute it, do it consistently so that you can track your progress. Collectors and customer service reps are more likely to turn over than management staff, but if you are above 50 percent, you have lots of opportunity for improvement.

Fair and consistent policies

As your company grows, it becomes more important to focus on how employees are treated. Do you have policies in place that are understood by all employees and applied on a consistent basis? Employees will feel slighted if they feel that there is favoritism.

Training and career development

Almost everybody wants a career path. People want to know that if they work hard and are productive, they will have an opportunity to grow into higher level positions. People expect and appreciate coaching and training that

will prepare them for promotional opportunities. Although training costs money initially, it will provide returns many times over in improved operations as well as employee satisfaction.

Systems

Employees get enormously frustrated over problems that affect their life at work. In any company with two or more employees, you will hear complaints about how another employee/department is messing up. While fingers often get pointed at people, the root cause is often a process or system that needs improvement. Next time you are in a staff or department meeting ask this question: "How many of you came to work today and intended to foul things up?" Of course everybody wants to do a good job. I suggest implementing some form of a quality initiative that aims to improve systems and work processes. Reducing rework and repeat calls can have a very positive impact on employee satisfaction.

Vision

People need leadership and a sense of direction. What is your vision? Do you strive to have the best results, the lowest prices, or achieve recognition for a specialty? Whatever it is, share your vision with everyone, so that all employees in your organization know what you are striving for. This will serve to keep employees focused on doing things right and doing the right thing. It also helps minimize constant changes that are disruptive to an organization.

Recognition

Last but not least, rewards and recognition are extremely important in maintaining a satisfied work force. People can adapt to all sorts of situations but everyone has a breaking point. Appropriate use of recognition will do wonders to build loyalty. If you can get employees involved in designing reward and recognition programs, you will have a happier staff at very little cost.

There is no single solution to reducing turnover. And some turnover is good – upgrading an organization may mean letting go of lower-producing employees. Spend some time with your staff discussing the above ideas. See which suggestions have more meaning or value for your organization. Implement those that you think will be easiest to accomplish or will have the most positive effect. The end result will be a more content workforce, lower employee turnover, reduced costs, and perhaps even happier customers.

Gary Zelamsky is a principal at Executive Alliance, a strategic partner of Kaulkin Ginsberg, and a leading national recruitment firm that specializes in the ARM industry. Contact Gary at hq@kaulkin.com.



Veteran Reporter Joins insideARM.com

By Patrick Lunsford
Editor, insideARM.com

For more than 8 years, Kaulkin Media has been focused on delivering the best news and information to the collection industry, one notoriously underserved by traditional media. We are now announcing the addition of a new team-member who will help us further our goal of being the best information outlet in the ARM space.

To better-serve our readers, we have brought on Burney Simpson as an editor at insideARM.com. Burney comes to us with over a decade of business reporting experience, most recently working as the managing editor of a premier monthly magazine for the credit card and processing industries. Burney will help us expand our coverage of the credit card and banking markets and allow us to drill down on internal ARM issues at creditor organizations.

It's an important step for our coverage of the ARM industry. Business development professionals at agencies

are adept at understanding the pain points of their creditor clients, but a lot of professionals in the collections operation – including executives – simply don't know what the accounts have been through to land on their desks.

So we will be exploring the internal ARM functions within creditor organizations further in coming months. We still have a mission to serve the third-party contingency debt collection industry, and we will never abandon that mission. Now, we will be supplementing this coverage with news and information from many of your clients and prospective clients.

Patrick manages all content for insideARM.com. Contact him with your news and comments at editor@insidearm.com, or call 301-907-0840 ext. 113.



Investment Analysts Assess Public Debt Purchasing Companies

By Burney Simpson
Editor, insideARM.com

The growth of the accounts receivable management industry in the last decade has captured the attention of Wall Street, with six publicly-traded firms building names for themselves as solid investments. Despite the fact that the industry's glow seemed to fade a little last year – two of the major players returned to the realm of the privately held, and rising debt prices slowed industry profits – investment analysts continue to watch and report on the industry.

Industry giants NCO Financial and West Corp., the parent of West Asset Management, went private last year, but investors are returning to watch the four remaining large debt purchasing firms – Asset Acceptance Capital Corp. (AACC), Asta Funding (ASFI), Encore Capital Group (ECPG), and Portfolio Recovery Associates (PRAA). All four trade on the NASDAQ market.

Analysts at investment firms have been updating their views of these companies, providing research reports that include an intensive review of the bottom line, a close-up view of quarterly reports, a regular double-check of the firms' business model, and a sizing up of their competition and industry prospects.

Two analysts recently released reports that demonstrated their focus. Daniel T. Fannon of Jefferies & Co. takes a

view of the broader debt purchasing environment and its effect on the individual firms. John H. Neff, an analyst with William Blair & Co., reviews closely the debt purchasing strategies of the four firms. A third writer, Toby Shute, covers debt purchasers for investment advice firm *The Motley Fool*.

Fannon covers financial service and consumer finance firms for New York-based Jefferies. In June, Fannon upgraded his rating on both Portfolio Recovery Associates and Asset Acceptance from "Hold" to "Buy."

Fannon told the *Bulletin's* sister publication, *insideARM.com*, that the supply of debt should rise in the second half of this year, and that could mean a pull back from the high prices seen in the last few years. Meanwhile, credit card charge-offs have been rising at such major issuers as Capital One, Citibank, and Bank of America, and that typically leads to more debt paper available. "We'll see a supply-side pick up. There are signs prices will improve," says Fannon.

Additionally, Fannon writes that "industry participants" tell him they see less competition for debt paper and fewer of the "irrational purchases" that have sent prices higher. Short-term profit seekers are exiting the market and leading to a modest decrease in demand for receivables.

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Investment Analysts Assess Public Debt Purchasing Companies (Continued)

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Portfolio Recovery Associates is a very well-run company that has “the lowest cost structure in the industry,” Fannon writes. For instance, its ratio of collections to operating expenses tops its competitors Asset Acceptance and Encore. Fannon has a price target of \$68 for Portfolio Recovery Associates, up from \$50 and a target of \$19 for Asset Acceptance, up from \$18. In mid-July, the stock of Portfolio Recovery Associates set a 52-week high, closing at \$64.45.

The stock of Asset Acceptance has been trading around \$17.50. In June, the company announced it spent about \$75 million to buy from its investors more than 11 percent of its shares outstanding through a buy back program and a special tender offer.

Neff covers business services firms for Blair, a Chicago-based investment manager with a focus on quality growth companies. Neff has an “Outperform” rating on Portfolio Recovery Associates and a “Market Perform” rating on Asset Acceptance. He follows, but doesn’t cover, Asta and Encore.

Neff finds some basic differences in the way purchasers go about buying debt. Some companies buy a portfolio then quickly sell, or “flip” it, for a quick gain. That may create impressive-looking gains in one quarter, but the numbers are not indicative of the growth and operating efficiency of the company, writes Neff in his latest “Collection Disclosure Insight Quarterly.” A portfolio sale inflates current results at the expense of future gains, he writes, and that has been “particularly true in the rising price environment for portfolios” since 2004 “in which flipping to the greater fool has been that much easier.” Those sales entice investors because they puff up a company’s earnings, but the numbers are temporary at best, because the earnings are nonrecurring, writes Neff.

He notes that Asta and Encore have been active portfolio resellers in recent quarters. Neff estimated that portfolio sales accounted for 25 percent of Asta’s revenue and 36 percent of its net income for the combined period of the fourth quarter of 2006 and first quarter of 2007. For Encore, during the first quarter alone, Neff estimated that

portfolio sales accounted for 11 percent of its revenue and 76 percent of its net income. In contrast, neither Asset Acceptance nor Portfolio Recovery generated any revenue or net income from sales of debt portfolios during the first quarter of 2007, Neff found.

Neff also shines a spotlight on Asta for its practice of taking on debt to buy debt. In the fourth quarter of 2006, Asta’s net debt per share was \$6.95. That skyrocketed to \$25.12 in the first quarter, according to Neff. In comparison, Portfolio Recovery Associates recorded \$1.68 of debt per share that quarter and Asset Acceptance had 8 cents per share.

“There’s nothing wrong with going into a net debt position if there’s an opportunity to buy debt at attractive prices,” Neff told *insideARM.com*. “But if that portfolio doesn’t work out, or there’s a change in the [business] environment, that debt leaves Asta with little wiggle room.”

Asta caused its debt per share to jump in February after it paid \$300 million for a portfolio with \$6.9 billion in face value of debt. Neff noted that the portfolio was “heavily shopped” and Asta paid two to three times what some competitors bid for it. (Kaulkin

Ginsberg initiated this transaction.)

Asta’s management justified the high price during a conference call with analysts, according to Shute with *The Motley Fool*.

Shute wrote that the portfolio was comprised of higher quality credit card debt – Asta’s specialty. Further, \$1.1 billion of the debt had already gone through litigation, with judgments awarded, meaning less work for Asta. He added that much of the rest of the debt could be garnered through legal action, or it could be outsourced, or sold off in the debt market.

Asta doesn’t rely on the call center structure that Portfolio Recovery uses to recover debt, instead “collecting via the court system,” outsourcing portions when possible and selling the rest “back into the market, presumably at a small premium,” according to Shute.

Management’s reasoning may or may not justify the high
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“ For Encore, during the first quarter alone, Neff estimated that portfolio sales accounted for 11 percent of its revenue and 76 percent of its net income. In contrast, neither Asset Acceptance nor Portfolio Recovery generated any revenue or net income from sales of debt portfolios during the first quarter of 2007. ”

Investment Analysts Assess Public Debt Purchasing Companies *(Continued)**(Continued from page 5)*

premium that Asta paid for the portfolio but investors seem to have taken the comments to heart. Asta's stock has gone up from about \$30 in February to \$43 in mid-July.

Encore Capital seems to get a little less coverage from analysts. It saw its stock jump in April from about \$10 a share to more than \$12 following the announcement that investors J.C. Flowers & Co. and FPK Capitol had bought 25 percent of the company's shares. The next largest investor in Encore is Red Mountain Capital Partners, with a 15 percent share.

Other investment firms that cover the ARM industry include Davenport & Co.; First Analysis Corp.; JMP Securities; Keefe, Bruyette and Woods; Roth Capital Partners; and, Utendahl Capital Partners. Early this

summer, Audrey Snell at New York-based investment house Kaufman Brothers initiated coverage on Asta and Portfolio Recovery with "Buy" recommendations.

Analysts bring expertise to their reports on the companies they follow, providing greater understanding and a more comprehensive view of the firm. An investor can agree or disagree with their conclusions but the ARM industry benefits from the critical eye that analysts share with their firm's clients.

Burney Simpson is an editor and reporter for insideARM.com, where he covers a broad range of creditor and financial markets. Burney can be reached at editor@insidearm.com.



Upcoming Events

Our Calendar of Events is printed and mailed out four times per year, to help you plan for the coming months. If you aren't on our mailing list but would like to be, please [send us an email](#) with your current mailing address.

To review a complete listing online, please visit www.insideARM.com/events.

We will be attending the following upcoming events. If you would like to meet with us in person at one of these events, please email hq@kaulkin.com to schedule a confidential discussion.

ACA Int'l's 68th Annual Convention & Expo**July 25-28, 2007 – Chicago, IL**

Patrick Jeanty from insideARM.com and Mike Ginsberg and Michael Lamm from Kaulkin Ginsberg will be on hand at this annual event.

Debt Connection Symposium & Expo 2007**September 5-7 – New York, NY**

Join us at this premiere event in the heart of New York. Kaulkin Ginsberg is proud to be a media sponsor again this year.

On Thursday, September 6, Associate Michael Klozotsky will be moderating a panel of healthcare creditors and agency executives, as they discuss the market for healthcare receivables.

Also on-hand at the show will be Kaulkin Ginsberg's Mike Ginsberg, Jamie Welsh, Michael Lamm, and insideARM's National Sales Director Patrick Jeanty.

About Kaulkin Ginsberg

We've been providing ARM executives with value-add advice, expertise, and information to make well-informed decisions for over 15 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, publisher of the most popular sources of industry information such as insideARM.comTM 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.