Executive Summary:

The Kaulkin Report

The Future of Receivables Management

KAULKIN GINSBERG

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Executive Summary

Consumers in the United States are highly leveraged, paying an increasing share of their incomes to cover their debts, according to the Federal Reserve. As economic growth slowed in the first half of 2007, more consumer debt became delinquent or went into default. These trends and other economic conditions will place more financial pressure on American consumers, particularly as credit quality continues to weaken and as the economy finally turns.

Creditors in the credit card, telecommunications, utilities, and government industries manage their receivables in different ways, yet all have turned to accounts receivable management (ARM) companies to improve their financial performance. Creditors' reliance on and expectations for ARM companies will increase with their receivables management needs.

Regulators on the Federal, state, and local levels frequently add to the rules governing the ARM industry. The Federal Trade Commission is likely to recommend changes to the Fair Debt Collection Practices Act to a Democratic Congress in 2008, and the likelihood of a Democratic president in that year suggests that greater regulation of the ARM industry is forthcoming.

Contingency Collectors recover debts for creditors and are paid some percentage of their recoveries. We estimate that this market had revenues of $10 billion in 2006 and forecast that it will grow 3 percent annually to $11.6 billion in 2011. Lower pricing, client consolidation, and increased competition will force these agencies to control costs in order to maintain profitability.

Debt Buyers acquire, service, and liquidate portfolios of delinquent debt. We estimate that this market had revenues of $3.7 billion in 2006. In coming years, this market will grow more rapidly, at 11 percent annually to $6.2 billion in 2011. The barriers to entry and profit potential in this market make it one of the most attractive parts of the ARM industry.

First Party Collectors pursue overdue accounts for a fixed fee early in the lifecycle of the receivable and typically under a creditor's brand. We estimate that this market will grow moderately at 2 percent annually from $1.8 billion in 2006 to $2 billion in 2011. The most successful competitors will provide creditors with first party services other than collections.

Collection Law Firms utilize the legal system to collect debts on behalf of creditors, debt buyers, and contingency agencies. This is the smallest but fastest growing market in the ARM industry, and we expect that it will grow at 16 percent annually from $1.1 billion in 2006 to $2.4 billion in 2011. The services of these companies will continue to diversify in coming years.

Mergers and acquisitions have been constant throughout the history of the ARM industry. The current seller's market is expected to cool in coming years, particularly in the event of slower economic growth. While these transactions tend to be cyclical within the ARM industry, M&A will continue to be used by owners seeking to grow and exit their businesses.

In sum, the ARM industry will continue to be segmented by service offerings. Rapid growth in certain markets within the ARM industry will allow certain companies to generate consistent operating margins of 25 percent or higher. In more mature markets, companies are less likely to maintain this level of profitability without diversifying their business models. As a whole, we expect the ARM industry to grow at an annual rate of 6 percent from $16.7 billion in 2006 to $22.2 billion in 2011. In the process, many ARM companies will continue to create value for clients and investors alike.

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