

Debt purchase at EOS

## Simply solvent

*In times of poor payment behaviour, securing liquidity is more important than ever. Selling debt portfolios provides quick liquidity and frees up lines of credit.*

Many companies have them. Folders full of money that are neither well-hidden nor secured behind sturdy vault doors. Usually they are simply stored in large cupboards in the administration offices: outstanding debts.

96 per cent of the debt-collection companies questioned in the current autumn survey conducted by the Federal Association of German Debt Collectors (Bundesverband Deutscher Inkasso-Unternehmen e.V. – BDIU) confirm that payment behaviour at the end of 2009 was just as bad as, or even worse than, it had been in the spring of the same year. One company in every two is expecting it to deteriorate further in 2010. Justus Hecking-Veltman, CFO of the international EOS Group, explains: “All over Europe, bad debts and delays in settling receivables are very high on the list of reasons for corporate insolvencies.”

### Financial needs in times of crisis

According to the German Factoring Association (Deutscher Factoring Verband), the number of corporate insolvencies in Europe in 2008 rose by eleven per cent to just over 150,000 compared with the previous year. Irish and Spanish companies in particular were badly affected by the economic crisis, with increases of well over 100 per cent. Although fewer European and US companies have now become insolvent compared with the previous year, their number remains considerably higher than the average of the preceding years.

As the EOS Five Nations Survey ‘European Payment Practices 2009’ shows, the managers from Switzerland, the United Kingdom, Hungary, Bulgaria and Germany who were interviewed expect payment behaviour to deteriorate over the next two years. Companies throughout Europe face substantial delays in payment which put their short-term liquidity in danger. A survey of the Czech Chamber of Industry and Commerce revealed that three out of four customers do not pay until after the payment period has expired.

Furthermore, the European Central Bank’s ‘Euro Area Bank Lending Survey’ shows that there has been a significant tightening of lending standards since mid-2008. At the end of 2009, banks were still expecting a generally negative economic trend. This might curb lending, at least in the near future, which would be a hazard for businesses’ cash flow, investment in new products, research, development or internationalization strategies.

Quick liquidity is an option provided by selling debt portfolios. This process involves the selling of overdue, dishonoured receivables and loans to a purchaser such as the EOS Group. Total default of these payments is thereby ruled out.

### **Selling debt strengthens core business**

Selling debt offers further advantages to sellers: immediate liquidity. They have part of their outstanding receivables paid out, which enables them to adjust their balance sheets. This, in turn, enables companies to improve their ratings. Additionally, sellers reduce their costs in staff and materials by entrusting the entire debt collection process to the purchaser of the receivables portfolio. In this way they secure their liquidity instead of ploughing it back into the settlement of receivables.

Administration, recovery and settlement are just a few of the time-consuming and cost-intensive factors that can be minimized with by selling on debt. "The point where receivables are dishonoured marks the beginning of a complex process which encompasses the writing of first reminders, debt collection on customers' premises and balance-sheet management. For the overwhelming majority of companies, these are not part of their core competencies," explains Mr Hecking-Veltman.

### **Simple handling**

When a company decides to sell, the buyer first discusses the receivables portfolio with the seller in order to gain an impression of its current value. This as-is analysis, along with a random sample from the receivables package, constitutes the basis of the purchase price calculations. In the process, the individual receivables are classified according to their type, age, degree of securitization, liability constellations, order of priority, amount, handling method and, above all, their probable default rate. Statistical projections and their own empirical experience also help purchasers to calculate a realistic price for the receivables. If both parties are agreed, they secure the transaction by contract. In this way, all of the rights and duties of the original creditor devolve upon the purchaser of the receivables.

EOS buys defaulting receivables portfolios whatever their composition: from those with out-of-court reminders to those where a judgement has already been executed. "In the financial year 2008/09, the EOS Group purchased receivables with an aggregate nominal value of just under one billion euros, half of which was in Germany. Specializing in debt collection enables EOS to work more efficiently than companies with a different core business," explains Mr Hecking-Veltman. Risk analysis models, well-staffed debt-collection teams and close contact with law firms are the crucial parameters for successfully finding individual solutions for each of the debtors.

### **Respectability of seller and purchaser**

The important point for the seller is to seek a trustworthy partner who has the appropriate knowledge and experience in the field of debt purchase. Although every time a receivable is sold the defaulting payer is notified that the receivable is being handled by the buyer or some other service provider, the defaulting party often associates his unpaid bill and its handling with the original creditor. The EOS CFO emphasizes how important it is for the debt-collection company to adjust its approach to handling receivables to that of the seller: "Debtors must be treated with sensitivity rather than being seen as a source of money. This approach upholds the company's image and

prevents the sale of the receivables from turning into a boomerang for its business strategy.”

### **The market**

The United Kingdom has been a leading force in the purchase of debt portfolios for some years now. In 2007, the UK was responsible for more than half of the debt purchase transactions in the European Union. Yet the market has been thriving throughout Europe. According to the Federation of European National Collection Associations (FENCA), more than 60 per cent of the largest European companies involved in debt purchase say that their business is growing steadily. In 2007, debt purchase already accounted for 18 per cent of the debt-collection services rendered in Europe.

### **Links**

- BDIU: <http://www.inkasso.de/presse/herbstumfrage/index.html>
- DFV: <http://www.factoring.de/index.php/factoring-aktuell/bz-1-hj-09>
- EZB: <http://www.ecb.int/stats/money/surveys/lend/html/index.en.html>
- FENCA: <http://www.fenca.org/index.php?page=surveys-2>

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