

INVESTOR'S BUSINESS DAILY®

Monday, June 16, 2003

The New America

PORTFOLIO RECOVERY ASSOCIATES INC. Norfolk, Virginia

Finding A Gold Mine In Someone Else's Debt

BY MARILYN MUCH

INVESTOR'S BUSINESS DAILY

Just when you think you've gotten the last credit pitch for a while, it seems a new one shows up in your mailbox the next day.

Companies that market credit cards have always been big on promotions. Now the soft economy and low interest-rate environment have kicked things up a notch, leading marketers to flood mailboxes with special offers.

The sweeteners vary. Some let you transfer balances at zero interest for a year. Others give you checks you can use for shopping, with 1.9% interest for three months.

Americans are buying into it in spades. From Dec. 31, 1997, to Nov. 30, 2002, consumer debt climbed 37% to \$1.7 trillion, according to the Federal Reserve.

As the credit market grows, so does the size of defaulted debts, or charge offs, that credit issuers must write off.

For the April collection period, credit card charge offs went up 44 basis points from a year ago to 6.85% – the highest level since August 1997, according to the Fitch Ratings charge-off index.

The more charge offs there are, the more business for Portfolio Recovery Associates Inc. It buys portfolios of charged-off receivables, mainly from credit card companies, at a

fraction of their value. Portfolio keeps the money it collects.

It's collected plenty in the past year or so. The firm's year-over-year sales have grown at least 58% the past five quarters. Earnings have more than doubled in four of those quarters.

"We're seeing growth from our core (credit card) business, plus we're seeing (business from) new entrants like telecommunications firms and utilities," said Chief Executive Steven Fredrickson.

'Open-Ended'

The idea of purchasing assets at a discount and collecting charged-off debt spans a lot of areas beyond credit cards, says analyst Audrey Snell of Brean Murray & Co. She cites unpaid phone, utility and tax bills as examples.

"This is open-ended (because) the technique can be applied to a receivable of any kind," Snell said.

Over the past two years, Portfolio has bought a small amount of charged-off telephone-company accounts on a test basis, Fredrickson says.

The company also considered branching into other areas, such as student loans, and gas and electric bills.

It tends to run small tests as it moves into new lines of receivables to make sure it understands how they're collected, Fredrickson says.

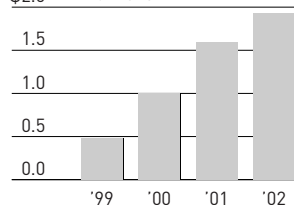
According to a conference call transcript provided by the Fair

A Pile Of Debt

Portfolio Recovery buys debt others can't collect, then collects the money itself and pockets what it gets. Lately the firm has plenty of business

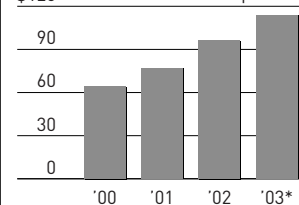
Debt portfolio acquisitions

\$2.0 In billions



Cash collections per hour paid

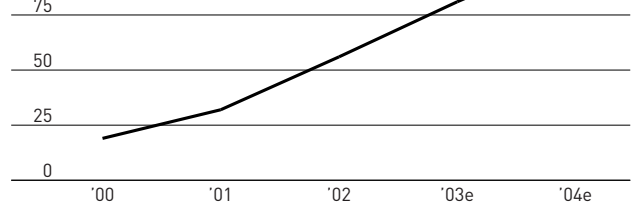
\$120 *first quarter



Annual revenue

\$100

In millions



Sources: Company reports, Brean Murray & Co., JMP Securities LLC

Disclosure Financial Network, Portfolio's first-quarter asset buys included telecom accounts, installed loans and lines of credit, in addition to credit cards.

Still, about 75% of its purchase volume in terms of dollars invested was in credit card accounts.

The Gift That Keeps On Giving

Portfolio's first-quarter revenue rose 58% from the prior year to \$18.3 million, while earnings were up 53% to 29 cents a share.

First Call analysts expect full-year earnings to rise 30%

to \$1.22.

"One of the things fueling growth is we collect these receivables over a long time frame," Fredrickson said.

The money it makes on each portfolio accrues yearly over time. For instance, the firm paid \$3 million for certain portfolios in 1996. It collected \$548,000 on those deals in 1996 and \$496,000 last year.

Portfolio keeps its bottom line fit by maintaining a productive collection staff, says analyst David Scharf of JMP Securities LLC.

"They've done a terrific job

in minimizing the turnover and maximizing the productivity of their collectors,” Scharf said.

In the first quarter, Portfolio’s receivables per hour paid – which measures the amount of cash each collector brings in – rose to more than \$114 from an average of \$96 for all of 2002.

Some of that improvement was due to the fact that the first quarter is typically strong for collections because a lot of folks get tax refunds, Fredrickson says.

At the same time, analysts credit Portfolio with doing a good job motivating and retaining its collection staff.

Snell points out that collectors are treated more like sales reps than clerks. They even go through a six-week training course to help them become skilled negotiators.

Super Model

Portfolio is also adept at bidding and paying the right price. Before it bids on a deal, it runs its pricing model on special software and arrives at a price.

“We stay true to that pricing model and we have discipline not to bid beyond what our model suggests,” Fredrickson said. “This is one thing that’s helped us avoid bad buys.”

Analyst Snell sees potential for continued growth because as the credit market expands, the charge-off market will grow along with it.

“The revolving debt collections industry is enormous and there’s a growing supply of receivables to buy of various types,” she said. “A skilled operator should be able to do well because of the continuing supply.”

Scharf is more cautious, mainly because

Portfolio’s success has been noticed by potential rivals.

“Competition is escalating,” he said. “There’s really a question of whether the larger portfolio purchasers will be able to enjoy as attractive pricing as they’ve seen in the last 12 to 24 months.”

Portfolio Recovery Associates portfoliorecovery.com

Ticker	PRAA
Share price	Near 30
12-month sales	\$62 mil
5-year profit growth rate	97%

IBD SmartSelect Corporate Ratings

Earnings Per Share	99
Relative Price Strength	89
Industry Group Relative Strength	C+
Sales+Profit Margins+ROE	A
Accumulation/Distribution	B-

See investors.com for more details
