

ARM M&A Activity - On A Rampage!

2006 will indeed go down in history as a record shattering M&A year in the ARM industry, with roughly \$3.5 billion in total deal value expected. In 4Q 2006, the \$1.26¹ billion management buyout of NCO Group (NASDAQ: NCOG) is expected to close, as well as the \$4.1² billion recapitalization of West Corporation (NASDAQ: WSTC). M&A activity has not been limited to just these record setting, high-profile deals; small to mid-size transactions in the ARM industry continue to take place.

The continued flurry of M&A activity so far in 2006 has been driven mainly by private equity firms located within the U.S. and internationally. These firms continue to be attracted to the above average profit margins generated by large, well run ARM companies, and the industry's organic growth and recession-insulated characteristics.

There has also been a great deal of interest in the growing healthcare sector of the ARM market, which has also seen an increased level of interest from M&A investors. In this issue, we provide a detailed look into the players in this space.

We produce these quarterly reports as a service to you, and would very much welcome your questions, comments, and feedback. Please feel free to contact any one of us – we look forward to speaking with you.

Sincerely,

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¹ \$1.04 billion of the \$1.26 billion represents ARM related deal value.

² \$585 million of the \$4.1 billion represents ARM related deal value.

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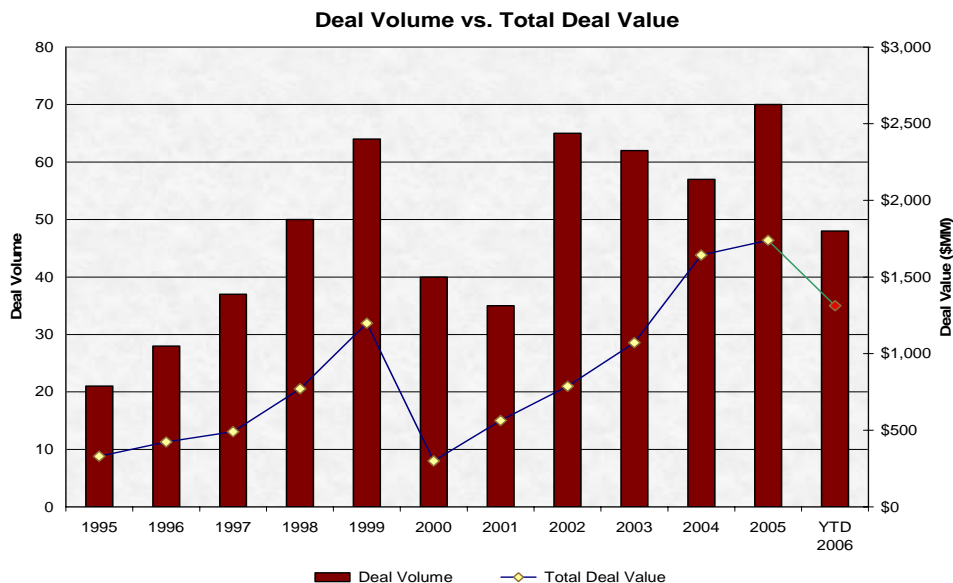
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About Kaulkin Ginsberg

Since 1989, Kaulkin Ginsberg has provided solutions to accounts receivable management and related business services companies. The Strategic Advisory Group provides merger, acquisition, and valuation advice; custom research; operational consulting; and executive search services. The Kaulkin Ginsberg family of companies also includes Kaulkin Media, publisher of the most popular sources of industry information such as CollectionIndustry.com™ and Credit & Collection Daily™; and Kaulkin Information Systems, provider of secure and affordable document and process management technology. Read more about Kaulkin Ginsberg at www.kaulkin.com.

3Q 2006 and 2006 Year-to-Date (YTD) Highlights

3Q 2006 was not as productive as 3Q 2005, generating 22 transactions and \$550 million in total deal value, as compared to 30 transactions and \$1.18 billion in total deal value in 3Q 2005. YTD 2006 is also slightly down from 2005's YTD results, producing 48 transactions and \$1.3 billion in total deal value, as compared to last year's 59 transactions and \$1.6 billion in deal value. However, Kaulkin Ginsberg is extremely confident that 2006 will far exceed last year's results due to an additional \$2.2 billion³ in pending deal value from announced transactions and other deals that exist in the marketplace.



International ARM M&A Activity

International companies played a major role in ARM M&A activity in 3Q 2006. Of the 22 deals that closed this quarter, 10 involved non U.S. companies: five Australian, two U.K., and one Indian, Canadian, and French company. Of the 10 international deals, two were considered cross-border transactions. It is expected that more cross-border M&A activity will be fueled by the growth and profit potential inherent in the ARM industry.

With all of the international M&A activity in 3Q 2006, it is evident that investors and buyers of ARM companies are looking beyond their own borders to invest in and/or acquire well-run ARM companies that produce high earnings. Mark Russell, Director of Kaulkin Ginsberg's Strategic Advisory Group, stated, "As the ARM market continues to globalize, investment firms and buyers of ARM companies are becoming more aggressive in locating acquisition opportunities in other geographic markets that support greater growth potential in the coming years."

Noteworthy Transactions in 3Q 2006

Financial

(July) Buchanan Clark and Wells (BCW), based in Scotland, and recognized as one of Europe's most innovative credit management organizations, announced its divestiture of its outsourcing division to Sovereign Capital, a UK-based private equity fund for \$52 million. The proceeds of the sale will be used to acquire additional companies to accelerate the expansion efforts of BCW Group's credit management arm. Management hopes that the deal will pave the way for BCW to become the UK and Ireland's largest credit management organization.

(July) Trans Tasman Collection (TTC), based in Australia, has made two acquisitions with backing from Allco Equity Partners and Deutsche Bank Capital Partners. One acquisition was of Baycorp Advantage Collection Services (ASX:

³ This figure is higher than was stated in the 3Q press release because KGC has become aware of additional pending transactions.

BCA) in early July for \$74.3 million. Under the deal, Baycorp Advantage Group will adopt a new name and brand within the next 12 months. A previous acquisition was a deal with John Pearce of Collection House (ASX: CLH). Mr. Pearce sold a \$2.75 million stake to competitor Trans Tasman who now owns a 10.3 percent share of Collection House. The sale took place just days after Stephen Walker, fellow Collection House co-founder, sold his 6.75 million shares at \$1 each.

(August) Clarity Credit Management Solutions Ltd, the rapidly growing debt collection agency formed just over one year ago, announced its sale of an 85% stake to Nikko Principal Investments Limited (NPIL). NPIL is the European investment arm of Nikko Cordial Corporation of Japan, one of the largest securities companies in Japan. This deal is a follow-on to Nikko's platform acquisition of Cabot Financial for roughly \$478 million. The transaction will enable Clarity to continue its growth and develop further opportunities for expansion. Both Garry Stran and Richard Griggs of Clarity will continue as significant shareholders in the business. Garry Stran will continue as Chief Executive and Richard Griggs will take on a new role as Director of Corporate Development. The terms of the transaction were not disclosed.

(September) B-Line, LLC, a Seattle-based specialty finance firm, announced that it has been acquired by Lone Star Funds of Dallas, TX. Lone Star acquired 100% of B-Line from Golden Gate Capital, a private equity firm based in San Francisco, California, who acquired the company in 2003. According to Ed Barton, B-Line's Chief Financial Officer, they will use this partnership with Lone Star Funds to strengthen their core offering of purchasing and servicing bankrupt consumer receivables. Bill Weinstein, founder of the company will be departing; however, senior management and staff plan to remain with the company after the transaction is complete. The financial terms of the transaction were not disclosed.

(September) American Capital Strategies Ltd (NASDAQ: ACAS), a publicly traded buyout and mezzanine fund with capital resources of roughly \$8.9 billion, announced that it has invested in the recapitalization of Marina Medical Billing Service Inc. Marina, established in 1981, is a leading provider of billing and collection services to hospital emergency department physician groups and physician practice management companies in six states. American Capital's investment was in the form of a senior term loan, senior and junior subordinated debt, and convertible preferred and common equity. Details on the terms of the transaction were not disclosed.

Industry

(July) Australian Receivables Limited (ARL), one of Australia's largest privately owned providers of ARM services, announced its sale of 75% of the company to NCO Group (NASDAQ: NCOG). The deal gives NCO an increased presence in the Australian debt collection market – a strategic move for NCO, as they have identified Canada, the UK, and Australia as key markets for growth over the next several years. The management team of ARL will continue to run the business and Paul Cooney, current ARL Managing Director, will remain a major shareholder. The financial terms were not disclosed.

Strategic

(July) National Bank of Canada, through its subsidiary National Bank Financial, established a platform in the debt purchasing industry by acquiring a majority stake in Credigy Solutions, Inc., a privately held purchaser of, and service-provider for, distressed consumer receivables with operations in the U.S. and Brazil. Credigy will continue to focus on the U.S. market as it expands its portfolio acquisition and servicing activities. Brett M. Samsky, Chief Executive Officer, and Steve Stewart, President, founded Credigy in 2001. They both plan to continue to lead Credigy and retain the remaining equity in the company.

(August) Armanti Financial Services, an industry leader in healthcare financial management, was acquired by Apollo Health Street (AHS), the BPO and IT outsourcing arm of India's hospital giant Apollo Group, for \$31 million. AHS plans to keep Armanti's operations in New Jersey, operating it as a wholly-owned subsidiary. This acquisition is expected to increase revenues for AHS to \$45 million in 12 months. Apollo has two other acquisitions in its sight that could push revenues to \$100 million within 18 months. AHS plans to continue to grow its operations and workforce both in India and the U.S. The newly-formed company will have over 1,500 employees, with nearly 25% of them based in the U.S.

(September) Coface Collections North America, Inc., a global distributor of trade receivables management and protection services, acquired Newton & Associates, a commercial debt collection company based in Louisiana. Newton will now operate as a division of Coface Collections. Newton's divisions in Denver, CO; Tucson, AZ; and Vancouver, WA, which employ 225 people, will remain in place. This strategic move extends Coface's presence in the U.S. commercial debt collection market.

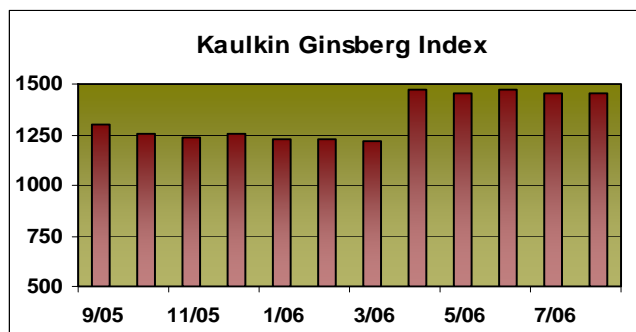
3Q 2006 Announced Transactions

The following is a list of the 17 announced ARM transactions out of the 22 completed transactions this quarter.

Month	Buyer	Industry	Seller(s)	Industry
July	Credit Corp. (ASX:CCP)	Debt Buyer	Pioneer Credit Management Services	Receivables Management
July	Trans Tasman Collections	Private Equity/Receivables Management	Baycorp Advantage Collection Services	Receivables Management
July	Sovereign Capital	Private Equity	Buchanan Clark and Wells Group Outsourcing Division	Receivables Management
July	NCO Group (NASDAQ: NCOG)	Receivables Management	Australian Receivables Limited	Receivables Management
July	Horwitz & Illecki	Receivables Management	Goldstein Bulan & Chiari	Receivables Management
July	Blitz Recovery Services, Inc.	Receivables Management	Island Credit & Collection Bureau	Receivables Management
July	AAN Financial Services Group	Receivables Management	Receivables Management, Inc (formerly Rehmann Receivables)	Receivables Management
July	National Bank of Canada's subsidiary - National Bank Financial	Private Equity	Credigy Solutions, Inc	Debt Buyer
August	Nikko Principal Investments Limited	Private Equity	Clarity Credit Management Solutions Ltd	Receivables Management
August	Repcol (ASX:RPC.AX)	Debt Buyer	Javelin SPV1 Pty, Ltd	Debt Buyer
August	Apollo Health Street	Receivables Management	Armati Financial Services	Receivables Management
September	American Capital Strategies (NASDAQ: ACAS)	Private Equity	Marina Medical Billing Service	Receivables Management
September	Trans Tasman Collections	Private Equity/Receivables Management	Collection House (ASX:CLH)	Receivables Management
September	Lone Star Funds	Private Equity/Receivables Management	B-Line, LLC	Debt Buyer
September	FirstCity Financial Corporation (NASDAQ: FCFC)	Debt Buyer	Small Business Lending Company	Specialty Finance
September	Zavata, Inc.	Receivables Management	Accordis Inc.	Business Process Outsourcing
October	Coface Collection North America, Inc.	Risk Management	Newton & Associates	Receivables Management

Kaulkin Ginsberg Index (KGI)³

The KGI Index presents an overview of the broad economic conditions in which ARM companies operate. It is based on seven macroeconomic factors that directly impact the ARM industry, though not on the financial results or operational metrics of ARM companies. Like the U.S. economy as a whole, the KGI remains strong at levels just slightly below its all-time high. The KGI remains up 13.5% compared to the previous year.



A closer look at three of the factors that contribute to the index (U.S. Public ARM Companies, Federal Fund Rate, and Bankruptcy Filings) will explain its slight decline throughout the past quarter.

³ KGI Index link - <http://www.kaulkin.com/research/kgi.cfm>

U.S. Public ARM Stocks

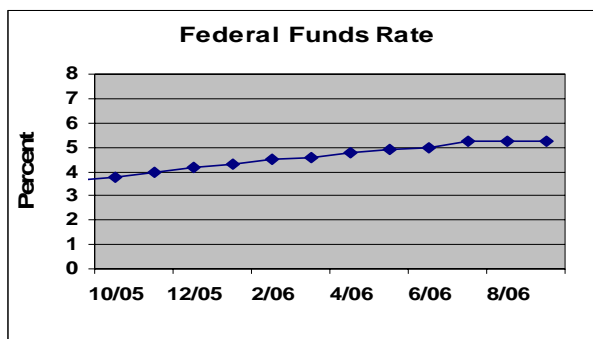
Although there are many publicly traded companies that compete in the worldwide ARM industry, its overall performance is best reflected by Asset Acceptance (NASDAQ: AACC), NCO Group (NASDAQ: NCOG), Portfolio Recovery Associates (NASDAQ: PRAA), Encore Capital (NASDAQ: ECPG), Asta Funding (NASDAQ: ASFI), and First City Financial (NASDAQ: FCFC). The total market capitalization of publicly traded ARM companies decreased slightly in the third quarter as a result of the pending management buyout of NCO Group by One Equity Partners and Michael Barrist for \$1.26 billion (\$27.50 per share). Changes in the total market capitalization of these six companies – soon to be only five companies – reflect the market's expectations about the industry's future financial performance. Increases as well as decreases in this figure cause the Index to rise and fall, respectively.

The stock performance of the publicly traded ARM companies in 3Q 2006 has not been as impressive compared to previous quarters; portfolio prices continue to be overly inflated. Asset Acceptance and Portfolio Recovery Associates recorded the biggest share price losses, -17.43% and -4.27%, respectively. Among the five companies, the best performer was Encore Capital, up 5.96% at the end of the quarter as the board announced intentions to explore strategic alternatives.

Company	Symbol	Open (7/3/06)	Close (9/29/06)	\$ Period Change	% Period Change	Opening Market Cap (7/3/06)	Closing Market Cap (9/29/06)
Asset Acceptance	AACC	\$19.68	\$16.25	\$-3.43	-17.43%	\$732.10M	\$604.50M
Asta Funding	ASFI	\$37.35	\$37.49	\$0.14	+00.37%	\$507.96M	\$509.86M
Encore Capital	ECPG	\$12.25	\$12.98	\$+0.73	+5.96%	\$271.95M	\$288.16M
FirstCity Financial	FCFC	\$10.44	\$10.57	\$+0.13	+1.24%	\$117.97M	\$119.44M
NCO Group	NCOG	\$26.33	\$26.22	\$-0.11	-00.41%	\$845.19M	\$841.66M
Portfolio Recovery Associates	PRAA	\$45.83	\$43.87	\$-1.96	-4.27%	\$710.37M	\$679.99M
AVG:		\$25.31	\$24.56			TOTAL:	\$3.18B
							\$3.04B

Federal Funds Rate

The Federal Funds rate continued its climb through 2005 and 2006 and just recently began to level off during the summer months. The change has helped create more opportunities for the ARM industry. When interest rate levels increase, adjustable rate obligations increase, creating more delinquent accounts to collect and more for purchase and retrade by debt buyers.

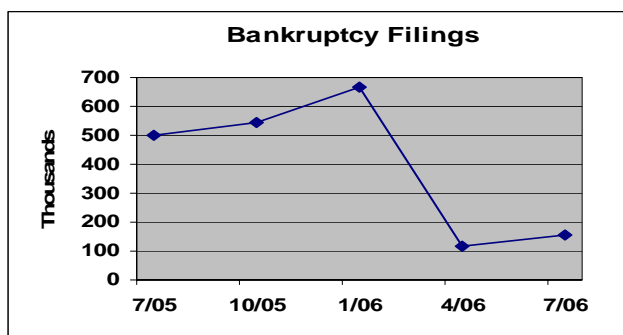


Any decision by the Fed to increase rates impacts the ARM industry in a number of different ways. For instance, higher rates equate to less of a debtor's income being spent to pay down debt for discretionary items (clothes, jewelry, TV, etc.), and more spent on non-discretionary items (mortgage, car payment, etc.). This allocation of income could make it more difficult for agencies and debt buyers to collect on certain classes of debt as well as older debt. In addition, private equity and venture capital firms could be affected by rising interest rates because

of the increased cost of capital. For these firms to make investments in a company, it is funded by debt and equity. When rates increase, the increased cost to investors enhances the level of risk and in turn demands a higher ROI.

Bankruptcy Filings⁴

The change in the bankruptcy law last year was excellent news for the ARM industry. The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), which went into effect in October 2006, makes it more difficult to file for bankruptcy and clear obligations. When a filing occurs, bankruptcy court proceedings take place first for the debtor and if his/her situation is in need of help, then a payment plan method (Chapter 13) will be setup through creditors in hopes that an actual bankruptcy filing (Chapter 7) can be avoided.



The number of bankruptcy filings was 116,771 in 1Q 2006. In 2Q 2006, bankruptcy filings increased dramatically to 155,833 which contributed to a slight drop in the KGI index. As the amount of debtors that file and proceed with bankruptcy increases, a smaller amount of debt is available to collect or purchase.

Current and Forward Looking M&A Trends

ARM companies are continuing to realize attractive values in today's market, but concerns are beginning to surface regarding how long this cycle will last. According to Mark Russell, Director of Kaulkin Ginsberg's Strategic Advisory Group, "In general, we are starting to hear some rumors that lenders are becoming more conservative in financing M&A transactions (meaning, they are lowering the multiple of EBITDA that they are willing to finance with debt). Some believe that this may be the early signs of an upcoming credit crunch, driven primarily by increased consumer and corporate bankruptcies and continuing softness in the economy and real estate market. If this is in fact the early warning of a legitimate trend and not just a rumor, then we could eventually see valuations for ARM companies start to decline because buyers, particularly investment firms, will have less ability to leverage their deals. However, at this time we are not seeing any negative impact on deal values or buyer interest level."

Going forward, Kaulkin Ginsberg does not anticipate buyer interest in ARM companies to change much in 4Q 2006 or into 2007, but the number of larger transactions will likely drop due to the limited number of seller prospects that remain available at this time. Russell notes, "There has been a lot of recent M&A activity involving financial and strategic buyers paying premiums above historical EBITDA multiples to acquire large debt purchasing and receivables management companies with strong management teams and organic growth performance. As a result, fewer companies exist that have the characteristics of attractive platform acquisitions for financial and strategic buyers. Those that do remain should be well received by the market as long as they continue to achieve growth and maintain their financial performance." Additionally, over the next 12-18 months, Kaulkin Ginsberg anticipates increased levels of M&A activity among private equity firms that have already invested in the ARM industry and seek to exit from these investments.

If the economy remains flat or softens over the next several months, buyers may start to require owners of ARM companies to accept a higher percentage of deal value in the form of an earn out or similar structure dependent on the company's future performance. According to Russell, "Today cash is king in M&A transactions due to the level of competitiveness that exists amongst buyers. Therefore, most transactions involving mid-sized and large ARM companies are being done either entirely in cash at closing or majority cash and some structure over time. Financial buyers have been leading the pact in terms of paying higher multiples due to their need to put money to work and ability to leverage their transactions with cheap debt. However, if the economy softens and/or lenders

⁴ Bankruptcy data for the third quarter of 2006 will not be published by the government until December.

become more conservative, financial buyers may need to increase the amount of structure in their offers. As a result, sellers may opt either not to sell or require a buyer to bring more to the table than just cash such as complimentary service offerings and/or clientele, enabling industry and strategic buyers to compete more effectively with financial buyers for M&A transactions."

Overall, Kaulkin Ginsberg believes that the ARM M&A market will remain highly active into 2007, but the environment is changing from a seller's market to a more even playing field between buyers and sellers. As a result, Kaulkin Ginsberg expects more deals to be completed by industry and strategic buyers that bring more than cash to the negotiation table, and deal structure may become more prominent in order for buyers to bridge the gap between their value and the sellers' expectations.

MARKET SPOTLIGHT

Financial and strategic buyers fan the flames of competition as they vie for competitive advantage in the healthcare revenue cycle management space.

Healthcare ARM: The M&A Scene Heats Up

By Kit Ladwig
Special for Kaulkin Ginsberg

"A hot spot." That's how one insider views the healthcare receivables market. Judging by the increase in M&A activity so far this year, interest is picking up steam. In the first three quarters of 2006, there have already been 15 transactions involving firms that specialize in healthcare revenue cycle management compared to 14 in all of 2005, according to the Strategic Advisory Group at Kaulkin Ginsberg. Total deal value has also risen from \$151 million in 2005 to \$166 million so far this year.

And more transactions are expected to close by the end of the year. "We have a couple of healthcare-related deals that may happen this year and one that will take longer," says Mike Ginsberg, President and CEO of Kaulkin Ginsberg.

What is causing the uptick in activity?

The market is huge and fragmented, with considerable room for growth. According to Kaulkin Ginsberg's recently released *Healthcare ARM Report, 2006*, the sector of the accounts receivable management (ARM) industry that serves the \$2 trillion healthcare market generated \$2.4 billion in revenues last year. With healthcare costs steadily mounting, and the number of uninsured and underinsured patients growing, healthcare providers increasingly are turning to specialists all along the revenue cycle to help improve their financial condition.

"Inefficiency creates opportunity," says Ginsberg, referring to the situation in healthcare business offices, which generally are understaffed and lack the latest technology for efficient and effective operation.

That trend has caught the attention of financial investors as well as strategic ones, including large business process outsourcers (BPO), ARM firms, and debt buyers. The result: a lot of potential buyers looking for attractive healthcare-related acquisitions. The challenge: Although thousands of firms collect on local healthcare accounts, not a lot, Ginsberg says, are of sufficient size to acquire. "In healthcare," he notes, "we're seeing competition in larger M&A deals for those with direct access to healthcare providers. Some firms are even owned by a group of healthcare providers and they are very attractive."

Who is funding deals, and why?

The answer in many instances: private equity investors. They are taking major stakes in leading firms, providing the wherewithal for firms to move into the healthcare space and for firms already in that space to expand geographically, increase their client base, and diversify the services they can offer their clients.

Some private equity firms, like Illinois-based RoundTable Healthcare Partners, which counts MedAssist, a leading revenue cycle management company based in Louisville, KY, in its portfolio, invest only in healthcare-related companies. Some, like California-based ClearLight Partners, which backs The Outsource Group based in St. Louis, Mo., elect to partner with an experienced hand like former OSI executive Michael Dimarco to enter and then expand in the healthcare ARM market. Still others, like American Capital Strategies which acquired Financial Asset Management Inc. in 2005, are already in the ARM market but aim to move into the healthcare sector.

Why the interest?

Private equity firms that have raised a lot of cash are looking for a place to invest it. "Like other parts of the industry, some private equity investors are seeing good investment opportunities and putting money to work," says Paul Legrady, Director of Research for Kaulkin Ginsberg.

The healthcare sector offers special attractions. "Healthcare collections is a fragmented, stable business. Clients generally don't change agencies often," says Bruce Colburn, president and CEO of Kadent, a Pennsylvania-based company backed by a group of private equity firms including CCP Equity Partners, SightLine Partners, and Quilvest. "A company with more nimble technology and economies of scale can offer better processes at a lower cost," says Colburn. The desire to attract larger clients and achieve cost synergies, he notes, prompts interest in acquiring additional firms.

The healthcare market is not quite as commoditized as markets like bankcard are, and it's unlikely to become so, says The Outsource Group's Dimarco. "Healthcare collections require a highly specialized understanding of billing and payer practices," he points out. "And while collections firms are fragmented, healthcare providers are too. That tends to equalize the power the buyer and seller have, with relationships relying more on the total value proposition, not just fee rate."

Cross-border and BPO deals

In addition to, or in partnership with, private equity firms, BPO firms, and debt buyers have also been in the hunt.

Cross-border acquisitions in healthcare ARM are not the norm, but they do occur. And they are not a one-way street. The flip side of the trend to offshore business processes: in August of this year Apollo Health Street, the business process outsourcing arm of India-based Apollo Hospitals Group, announced it had acquired Armanti Financial Services, a medical billing and receivables management firm with headquarters in Bloomfield, N.J. The price tag was \$31 million. According to Apollo, the combined companies handle more than \$1 billion in hospital and physician receivables, with nearly 25 percent of the firm's more than 1,500 employees now based in the U.S.

The Armanti purchase is not the first instance of an India-based BPO firm shopping in the States. In the larger ARM market two years ago, Mumbai-based ICICI OneSource purchased Account Solutions Group, a New York-based consumer collection agency. That deal enabled ICICI OneSource to add late-stage collections to the range of services offered to its customers.

"It's a development worth keeping our eyes on," Ginsberg says of the acquisitions by foreign firms. "Still," he points out, "most deals in this country involve U.S. players." One reason: many U.S. buyers are well-capitalized, at least for now. On the other hand, he notes, cross-border deals are influenced by the value of the dollar. When it's weak, such deals become more attractive.

Not all BPO-related deals involve firms from abroad. In late September, Atlanta-based Zavata Inc. announced it had acquired Accordis Inc., a New Jersey BPO firm serving healthcare providers, and its subsidiary, Progressive Recovery Techniques, a healthcare collection agency. Accordis was the fourth healthcare-related acquisition made by the firm in the past two years. "Zavata aims to be a comprehensive outsource provider for payers and providers," says Chemain Sanan, the firm's executive vice president. "We now own the entire cycle from patient intake, eligibility, and billing to collections.

"Accordis adds scale and special niche services - such as Medicare, Medicaid, and bad debt collection with a specialty in ambulatory and emergency medical services - to our healthcare provider services," she notes. Zavata, which initiated its provider services with the purchase of Siemens' Revenue Cycle Managed Services division in 2005, has served the payer segment for three years and now uses a blended-shore approach made possible by the acquisition last year of a Hyderabad, India-based company. "In healthcare, outsourcing business processes fully offshore does not make sense. You need the right mix for the customer," Sanan says. "Accordis, for example, has some government healthcare contracts that all must stay onshore."

Zavata's buying spree was aided by approximately \$80 million in equity financing raised from a group of investors, including Mellon Ventures, BV-Cornerstone Ventures LP, WestBridge Capital Partners, and technology entrepreneur Satish Sanan.

Debt Purchasing Deals

The purchasing of medical receivables is drawing increased interest from established debt buyers, as well as some collection agencies and other companies serving the healthcare market. The attraction: its enormous potential for growth. In this emerging market, debt sales activity level is still low compared to better established ones such as bankcard bad debt. According to Kaulkin Ginsberg's *Healthcare ARM Report, 2006*, healthcare debt accounted for only about \$3 billion to \$4 billion – or roughly 2.7% to 3.6% – of an estimated \$110 billion in face value of delinquent debt purchased in 2005. That's a very modest level of sales considering that U.S. healthcare providers annually set aside an estimated \$129 billion to cover their bad debt. Sensitivity to community and government reaction in an environment where medical care is considered a right not a privilege and most customers are local may mean some providers will never sell their debt. Still, an increasing number are recognizing it is a means to help them stabilize their bottom line and keep their doors open.

"Substantially all the healthcare paper purchased comes from hospitals," Legrady says. "And that should continue. Small physician practices and specialized medical facilities generally lack the volume to justify a portfolio sale. Still, look for more for-profit hospital chains to sell their receivables as they grow accustomed to the fatter and larger cash flows that can arise from portfolio sales."

For firms eager to establish a significant presence in this emerging market, acquiring an established company is the swiftest way. "Getting a smaller company with a history of services and references in healthcare collections and purchasing receivables is an easier way to grow and build a base of clients," agrees Algis Penkiunas, Senior Vice President, MEDCLR, a division of Pennsylvania-based NCO Group.

This year and last, two publicly traded debt buyers – NCO Group and Asset Acceptance Capital Corp. – opted for that strategy. In 2005, NCO, a leading player in healthcare collections handling a reported 11 million healthcare accounts a year for more than 1,500 healthcare providers, bought MEDCLR, Marlin Integrated Capital's medical debt-buying arm. By its own account, MEDCLR has purchased between \$4.5 billion and \$5 billion in healthcare receivables to date. Terms of the deal were not disclosed.

In April 2006, Asset Acceptance announced it had acquired Florida-based Premium Asset Recovery Corp., a company that had already purchased approximately \$1 billion in charged-off medical debt. The purchase price: approximately \$16 million, plus the assumption of certain outstanding debts and costs associated with the transaction. "This acquisition advances our medical purchasing and collection expertise," comments Brad Bradley, Chairman, President, and CEO of Asset Acceptance. "Additionally, this purchase gives Asset our first contingent collection operation that we may expand if appropriate."

Both PARC and MEDCLR brought to their respective unions not only their purchased healthcare accounts but extensive experience in valuing medical portfolios and predicting recovery rates – as well as all-important reputations and client contacts in this highly specialized niche, where liquidation rates and customer sensitivities vary significantly from those in other credit-granting industries.

Not every firm eyeing the medical debt sales market can – or wants to – buy its way in. "It's a question of supply and demand," Ginsberg points out. There may not be many companies of sufficient size to acquire, and there are not many with a history in this asset class.

CSI Financial Services in San Diego took another approach to gaining a foothold. In the business of partnering with banks to fund hospitals' self-pay and balance-after-insurance accounts for the past 14 years, CSI executives saw an opportunity at the other end of the revenue stream – charged-off debt. A year ago they joined forces with another firm to fund the purchase of receivables. "It's a very large, privately held company experienced in purchasing specialized, payment-intensive assets," Mitch Patridge, CEO of CSI Financial and Varisol, the newly formed debt buying firm, says of the unnamed partner. "They have the capital and analytics. We have knowledge of the healthcare space. They've bought charged-off consumer accounts. We leverage their analytics and they benefit from our knowledge of the industry." Another benefit: CSI can now offer clients a more complete solution: buying early-stage to late-stage accounts.

Collect America, a leading debt buyer based in Denver, began moving into the healthcare debt sales space about two and a half years ago, calling on hospitals, as well as ER and ambulance providers in Collect America's name, according to Tim Dahltorp, Executive Vice President, Strategy and Corporate Development. Dahltorp also oversees Healthcare Funding Solutions, the separate entity created last year for that specialty debt-buying niche. "Quite a few of our franchises had medical experience," Dahltorp says of the network of attorneys that service the debt Collect America buys. "We're also bringing it in via franchise sales. On the healthcare side, the franchises are

not 100% attorneys, although we prefer that." Last year also saw KRG Capital Partners, the leverage buyout firm, acquire a majority stake in Collect America for a reported \$350 million. Although KRG declined to be interviewed for this article, according to the January 2006 issue of *Collection Agency Report*, when the deal was announced KRG indicated it was interested in funding add-on acquisitions that would accelerate Collect America's expansion into new asset classes and expand its breadth of services. Targets cited included collection firms with experience in medical receivables, as well as secured and unsecured auto receivables and bankrupt accounts.

Competition's Impact on Price

All this buyer interest has had an effect on the multiples buyers pay for healthcare-related companies. "There's too much money chasing too few companies," H&R Accounts Eilemberg says. "With the multiples paid for some companies, I wonder how they will make money."

"Higher multiples mean it's a good industry and a good sector of the economy," says Jon Isaacson, managing director, American Capital Strategies Ltd. "We believe that to be the case."

Adds Dimarco: "The range we're seeing now is four to six times EBITDA. The higher multiples go to companies that are either specialized, have extraordinary profitability, strong top-line growth, and solid management teams. Paying higher multiples is acceptable if those factors are present and I can improve performance. If I can grow the business, I can increase profit down the road and the multiple is less important."

In a competitive environment like today's, Ginsberg observes, prices are usually high and cash is king. "A strategic buyer may be able to pay a higher multiple because of potential cross-sell or cost-saving opportunities," he says, "but private equity firms, who cannot count on synergies with their first purchase, have been unusually competitive due to the availability of cheap financing. It is very competitive."

As for multiples, Ginsberg points out that lower multiples are generally reserved for smaller companies. Larger companies – in healthcare, those with more than \$5 million in annual revenue – are commanding higher multiples and better deal structures. "The discussion for larger sellers begins at five to six times adjusted EBITDA, normalizing one-time expenses that will not reoccur and excess operating expenses that will not continue under new ownership," he explains. "That's provided the company has all the right ingredients to make it an attractive investment, including a diversified client base, sustainable revenues and earnings growth, a strong management team, and a clean track record."

M&A Outlook

"This year has been the largest year by far for ARM M&A and I see that continuing for the foreseeable future," Ginsberg predicts. "Interest rates are stable, the stock market is performing well, and capital is readily available."

Other industry insiders concur. "Private equity moves in a herd, notes Eilemberg, "and that's likely to continue."

"The activity of venture capital is picking up and M&A activity usually follows," says Zavata's Sanan about the broader healthcare revenue cycle management space. "We've seen a lot of investors, M&A activity, and consolidation in just a few years. And it will pick up. Financial buyers are moving in this space and strategic buyers are bidding actively. That speaks highly of the potential."

The bottom line: Buyer interest is not expected to cool off any time soon.

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