

## Analytical Valuations Drive Debt Purchase Success

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### *Valuation of Performing and Non-Performing Debt*

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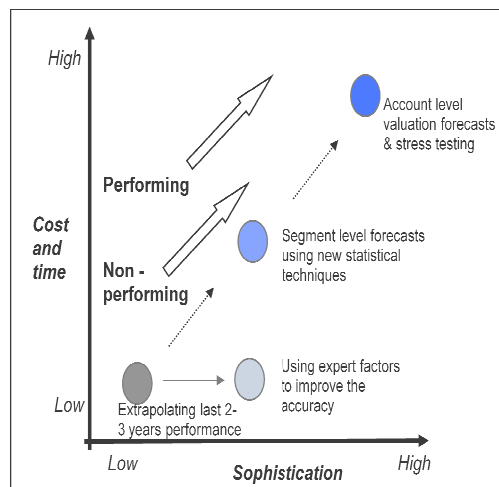
Valuation techniques used for performing debt (i.e. where the customer relationship is still active and contractual fees/interest are being paid) tend to be more complex than those applied for non-performing debt (i.e. where the customer's contractual relationship is broken and the debt is being collected out).

This higher level of complexity for performing debt has been driven by:

- more complex behaviours of performing accounts which, in addition to repayments, will have account closure, delinquency, refinancing and account spending transactions
- the richness of available data
- the larger size of performing deals and thereby a need for multiple investors and stakeholders to back a single deal

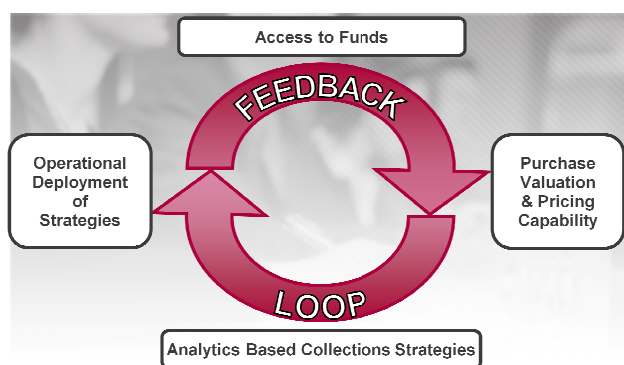
This has resulted in methodologies being developed that not only allow a baseline valuation to be produced but also allow for stress testing and scenario analysis. These can provide investors with increased confidence about potential post-purchase outcomes.

On the other hand, the non-performing debt purchase market has seen rapid development, with sellers looking for tactical P&L enhancing sales and buyers pursuing growth strategies. However, the high volume of deals and lower levels of data and transparency has resulted in the valuation of non-performing debt being less sophisticated and containing a significant element of expert judgement. In an era of rising house prices and high employment, buyers were still able to make



profit from their investments. However profit varied hugely across portfolios, with IRRs ranging from less than 5% to over 100%, indicating high price volatility and lack of understanding of underlying assets.

As the market matures and the economic cycle turns, there is a need for increased transparency and certainty to ensure on-going liquidity and an acceptable level of price volatility. This has started to drive the debt purchase market towards improved valuation techniques. Another motivating factor is the recent credit crunch which has resulted in funders wanting more certainty around the value of their potential investment. As a result, the debt purchase market is entering an interesting time where there will be more opportunities to buy, but increasing constraints on funds unless there is improved understanding, certainty and accuracy of valuations.



In this climate, increased analytical sophistication will become a key strategic advantage and a major part of the equation for the success of debt purchasers. A business that has sophisticated pricing and valuation capability, together with analytics based collection strategy setting and excellent operational deployment of these

strategies, can create an ongoing feedback loop. This ensures that all learning and information from existing portfolios is fed into future pricing decisions. In turn, this will provide the increased accuracy and certainty of outcomes that fund providers require and help to ensure achievement of ROI targets from purchase decisions.

Some buyers and sellers are now going a step further by embedding end-to-end portfolio management in their businesses, joining up sophisticated data management and modelling activities with robust MI and management processes. The result of this is a true understanding of where value is being created and destroyed in a portfolio and provides an ability to rapidly identify and react to emerging variances in performance. This provides a significant competitive advantage through more accurate valuation and “control” of outcomes.

In these changing times for the debt purchase market, there are significant returns for those businesses who drive out a good understanding of asset value using more sophisticated analytics. Those who fail to embrace this move forward will find it harder and harder to compete and to secure funding, with their wider price volatility leading to poorer purchase decisions with limited returns. With increasing pressures from the funding market and the economic slowdown, standing still will be a sure-fire way of moving backwards.