Euristix

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LATEST NEWS

Euristix have recently engaged with private equity firm Vision Capital to complete the due diligence on Scandinavian lender Nordax Finans. Details of this successful deal can be found here

Hello

Welcome to the July 2010 edition of Euristix Insight, our newsletter which seeks to deliver unique commentary and information in the changing world of credit and portfolio management.

The UK credit industry faces an interesting dilemma, with signs of growth and recovery tempered by fears of a double dip and further pitfalls. Caution is prudent, but an over-cautious approach could lead to missed opportunities and losing ground on competitors. It is vital to use the correct information to navigate the optimum course.

With economic developments under close scrutiny, our lead article looks at some of the standard industry measures relating to house values, including their usage and inconsistencies. Meanwhile, Questions Corner encourages you to consider how well placed your business is to both exploit and mitigate changes in the market. Finally, the latest of our Achieving Best Practice series discusses the process of valuation within due diligence; a task which is both more difficult and more critical in a volatile environment.

As ever, please contact us with any questions regarding any aspect of risk management or with feedback regarding our articles and newsletter.

Kind regards,

Chris Kemp

In this edition...

House Price Valuation Measures - This article discusses the oft-quoted house price indices used by many to track this aspect of the economy. We consider the usage of these tools and also highlight possible issues and inconsistencies inherent in these measures.

Questions Corner - As the UK economy faces a tipping point, businesses need to be in a position to react to changes both positive and negative. Take a minute to consider our questions and evaluate how prepared your business is to exploit change.

Valuation Analytics in Due Diligence - Investors are beginning to shrug off the paralysis that has affected them for the last few years. Here we consider the process of producing analytical valuations to support the due diligence process, a task that has become more difficult and at the same time more vital in today's volatile environment.

Understanding and Using House Price Indices

Nowhere is the focus on economic development more pronounced than in the mortgage market, where lenders scrutinise the latest house price indices to help them understand the impact on their books. But are these indices reliable, and are we using them in the right way?

In this article Euristix considers some of the discrepancies between the most oft-cited indices and lays out an analytical process to maximise the value of these tools while avoiding any associated pitfalls. To read the full article, please follow the link **here...**

Questions Corner - Exploiting Economic Change

Many financial services businesses were unprepared for the changes wrought by the economic downturn. The question now is whether businesses are in a better position to adapt to change, both in terms of mitigating further deteriorations but also in terms of quickly exploiting opportunities. Consider the following quick questions:

- Do you have a clear view of how a significant increase in interest rates would impact your business?
- How much consideration has been given at senior level to how to

maximise the value of any economic upswing?

- Are you concerned that your competitors could react more quickly and more appropriately when facing external change?
- Do you have an understanding of how economic change will effect the performance of your portfolio at a granular account level? Do you use this to drive customer level actions?
- How well would your business weather the credit crunch if it occurred now? Are new processes and defences in place? Would your models and processes adapt dynamically?

In a future edition of Euristix Insight we will discuss how to make your business more adaptable to economic change, both positive and negative, but in the meantime, please direct any questions or queries to paul.matthews@euristix.com

Achieving Best Practice - Due Diligence Valuations

Problem - Investment in the financial services sector dwindled drastically in the wake of the onset of the economic downturn. A number of high profile casualties were the public tip of an iceberg that saw numerous businesses in the sector fail or falter. With performance levels stressed, returns collapsing and business models breaking, prudent investors stepped back from financial services as the storm raged.

As the dust settles however, a new landscape is emerging. Leaner, fitter businesses are preparing to thrive in an environment of reduced competition. With improved processes, adapted business models and successful futures ahead of them, these organizations are ripe for investment. With the promise of strong returns investors are finally returning to the financial services sector.

But how does a would-be investor differentiate between the success stories of the future and the terminally wounded hangers-on slipping into further decline? It is important not just to understand the potential value of a financial asset, but also the risk to this value and the volatility under distressed and non-distressed circumstances. And this insight needs to be distilled within short timescales based on limited information provided by the seller.

Approaches - As ever, analytical valuations and forecasts are an integral part of the due diligence process enabling investors to understand and value a business. The difficulty arises, of course, from the high levels of instability that have affected the financial services sector in recent years. Economic volatility, internal changes and reduced competition are making it much harder to distill a true view of a business's worth. For some the impact has been negative, with the future promising recovery and growth. For others, reduced competition has brought halcyon times and the challenge lies in understanding how stable this will prove in a warming market.

As investors look to value businesses extremely carefully, many are demanding more and more data from sellers, including account level information. Rich data can be incredibly useful in building valuation and forecast models, and the quality of the data itself can be hugely telling about the business under consideration. The risk however is that the limited time available for due diligence will be burnt in data preparation, validation and manipulation, without obtaining a truly insightful valuation understanding both cause and effect.

Alternatively, it is possible to base valuations heavily on MI provided by the seller and to use segment level information to forecast future performance. This reduces the focus on data intensive processes and allows more time for analyzing the portfolio. The limitation here of course is that the segmentation and performance metrics used by the seller may not be ideal for gaining a true view of the business.

Best of Breed - The analytical aspects of due diligence remains a vital weapon in the investor's arsenal, but the key is to approach the process in the correct way. Combining analytical insight with deep sector and practitioner knowledge will enable an investor to derive the insight they require to make the right decisions.

The optimum approach combines tailored data analysis with a deep understanding of the sector and the use of benchmark information. This allows improvements or deteriorations in performance to be assessed in relation to the wider market and overlay a better context onto forecast models. The models themselves should be built using segmentation and metrics selected to suit both the modeling methodology and the key questions of the investor, and these need to be constructed in a way which does not sacrifice insight for excessive data manipulation.

Working within the constraints of the information that can be provided by the seller, it is possible to create a picture of how the business is performing, how this performance measures relative to peers, and how this will translate in the future. The final ingredient is to measure the volatility of this value both in an upturn and distressed sense. One component of this is an understanding of economic impacts, which can be achieved through the application of sector specific economic susceptibility models. Beyond this it is necessary to identify the key risks within the sector and to map this onto the forecasts, including any likely mitigation that could be put in place.

Separating the declining has-beens and faltering upstarts from the true stars of the future requires the combined power of analytics and practitioner knowledge. It is clear that the potential returns in the financial services sector are higher than they have been for many years, and getting the right valuation models in place can help investors maximize their slice of that. Euristix will provide further views on due diligence practices and best of breed approaches in future editions of Insight, but in the meantime please contact Paul Matthews paul.matthews@euristix.com with any questions.

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