

EUROPEAN OUTLOOK CONFERENCE

LONDON

# Debt Collectors: In Crisis Mode

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**CreditSights**

a FitchSolutions Company

Research

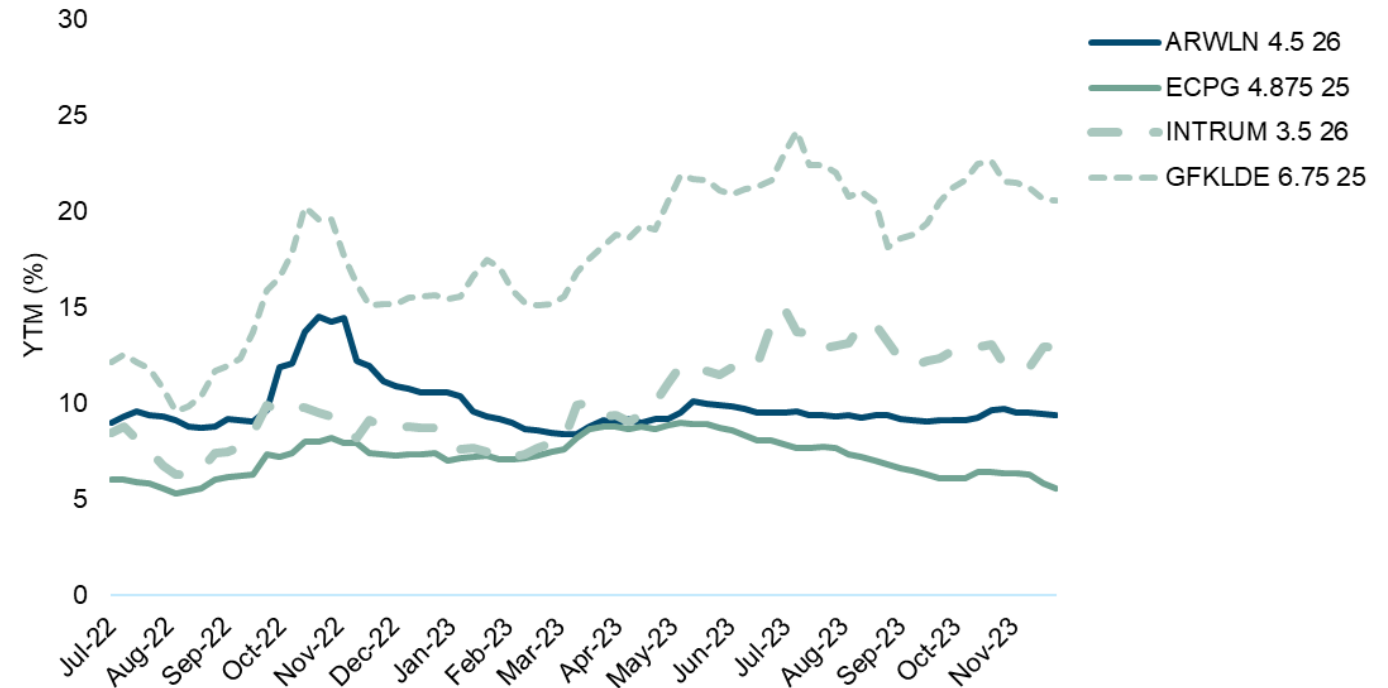
CovenantReview

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# The Music's Got More Expensive

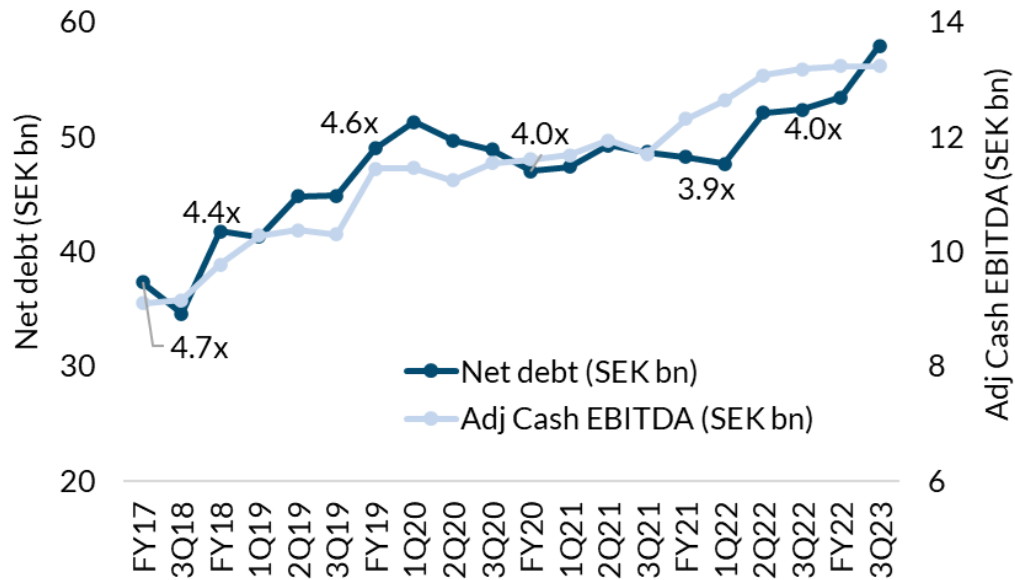
## Debt Funding Costs Spiked For The Sector in 2022

- Pre-2022: “Free” funding, sector used to mid-single digit yields
- Portfolio investment based on the principle that good times last forever.
- Cash flow profile invariably stretched.
- Credit risks recognised, but not fully priced in historically.
- Significant differentiation between issuers emerges over past year.

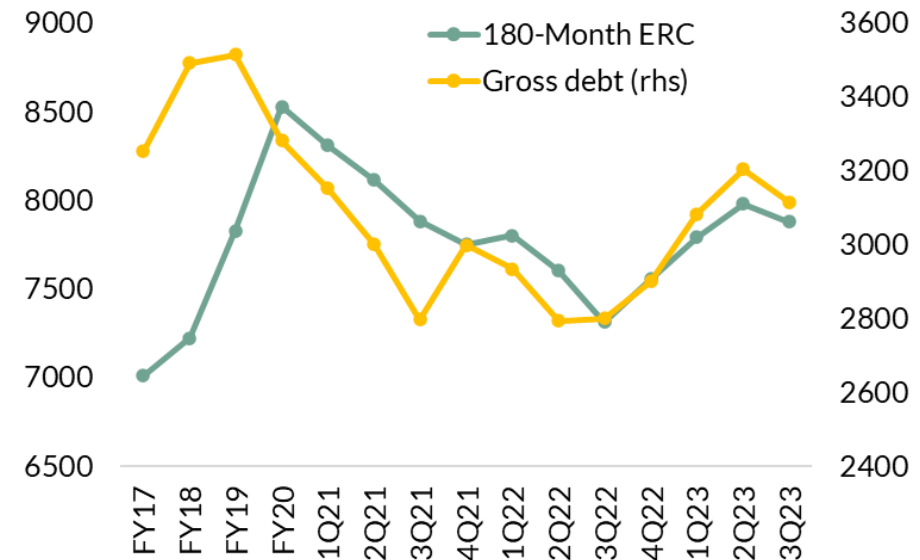


# How Did We End Up Here?

## Intrum: Debt Funded Growth



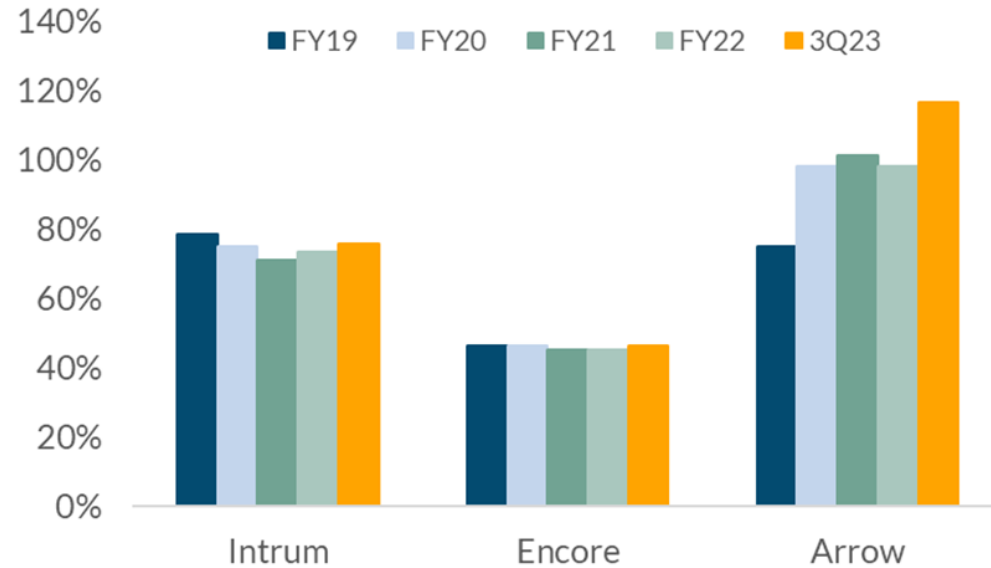
## Encore: ERC Versus Debt (\$ mn)



- Intrum's growth highlights sector story: portfolio purchases, alongside a steep climb in the debt pile.
- Sector typically debt funded, with some exceptions (GFKL and Arrow equity infusions).

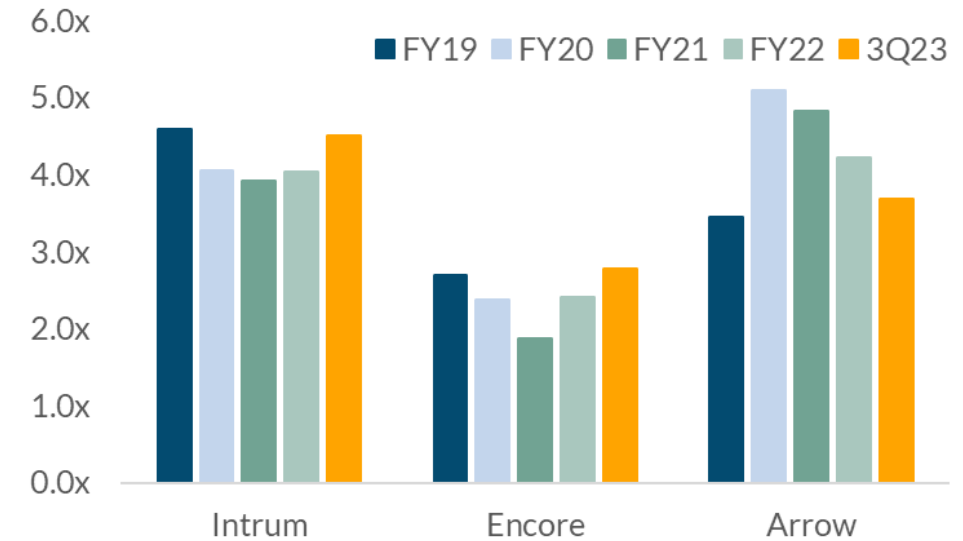
# Leverage Metrics Elevated

## Gross Debt to ERC



- Asset coverage metrics inadequate.
- ERCs an imperfect proxy, real picture more grim.
- Stressed LTVs under run-off based on existing books.

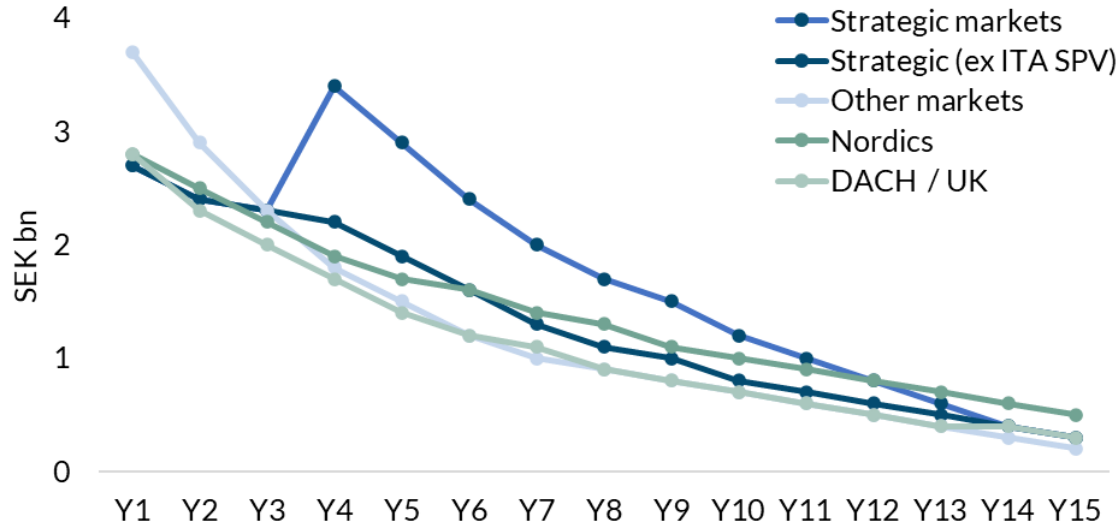
## ND / EBITDA



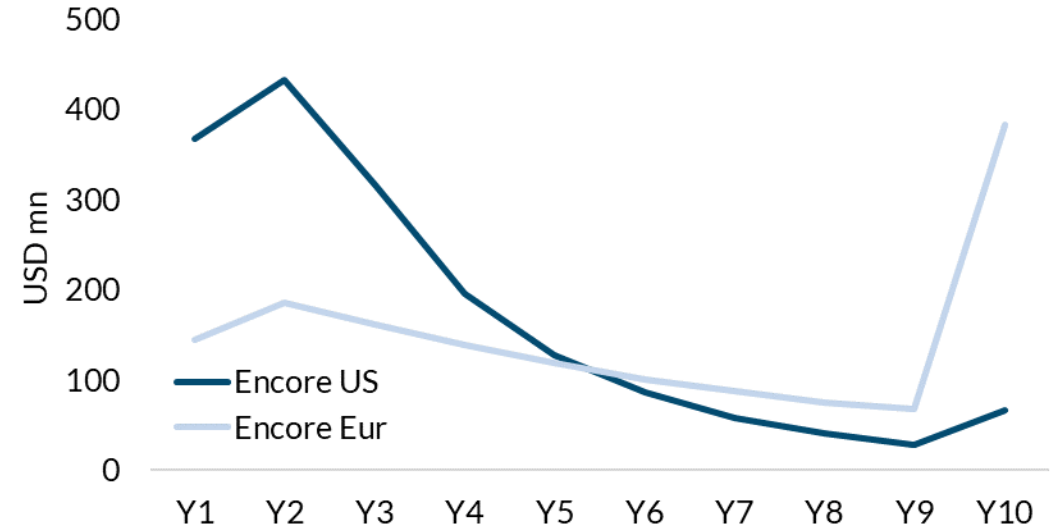
- Leverage high on purchasing led growth.
- Easy to “reduce” reported leverage through backbook sales... real leverage 4x-5x.

# Near Term Liquidity Supported By Existing ERCs

## ERC Profile: Intrum (as of YE22)



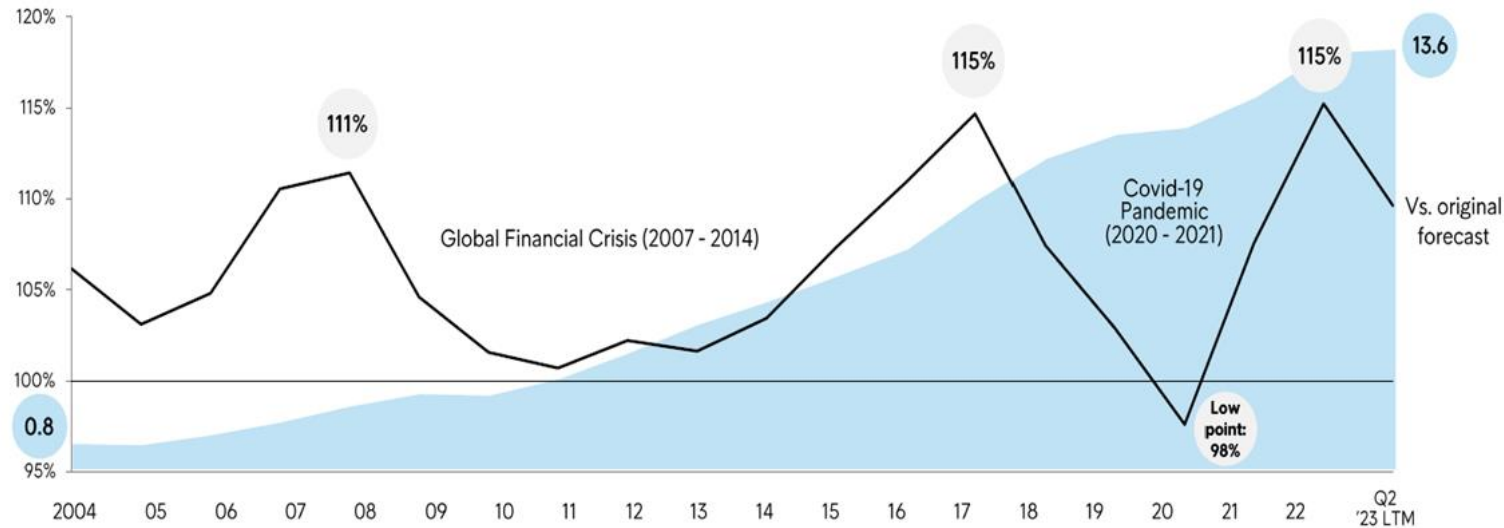
## ERC Profile, US Versus Europe: Encore (YE22)



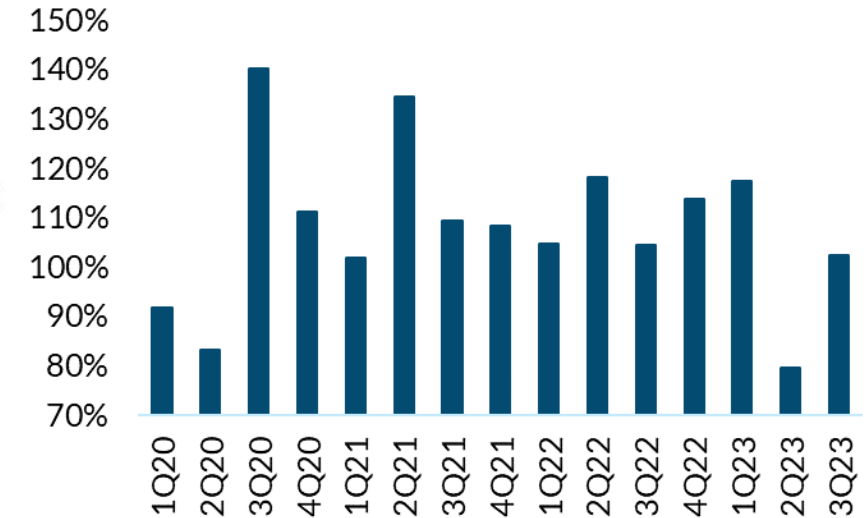
- ERC a common, DC specific metric, but imperfect proxy for valuation of purchased debt portfolios and security.
- No assumptions on future purchasing volumes but relies on collection estimates.
- Characteristic, smooth profile ERC due to highly granular DC portfolios but deviations occur (Arrow).
- ERC vs realisable value – cost of servicing, NPV, ERC tail collections.

# Collections a Concern, but Holding Up

## Intrum Collections Through the Cycle



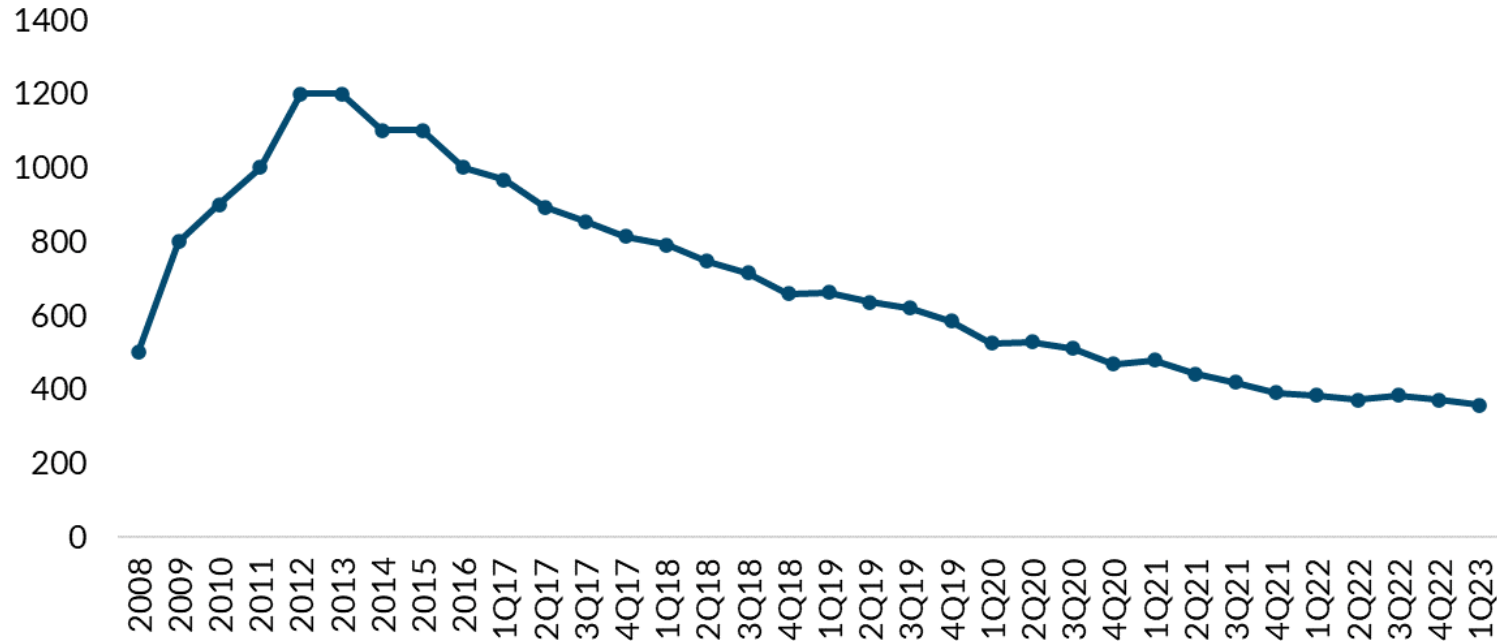
## Arrow Collection Profile



- Decline in collection levels – mitigated by payment plans and nature of business.
- Degree of elasticity and collection drops at least partly deferred rather than lost.
- Low point of sub-100% collections for Intrum and Arrow during Covid, but short lived (2-3 quarters before rebound).
- Collections (despite the odd scare) have stayed above budget in 2023.

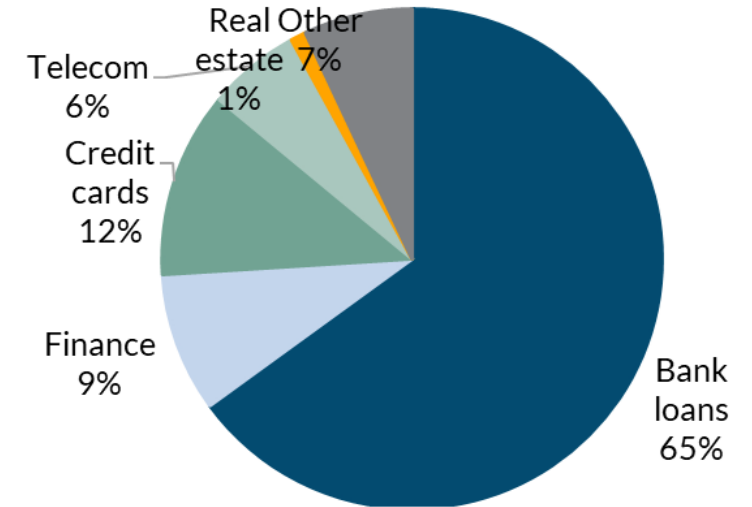
# Supply Remains Depressed in Europe

## EU/EEA NPLs (Eur bn)



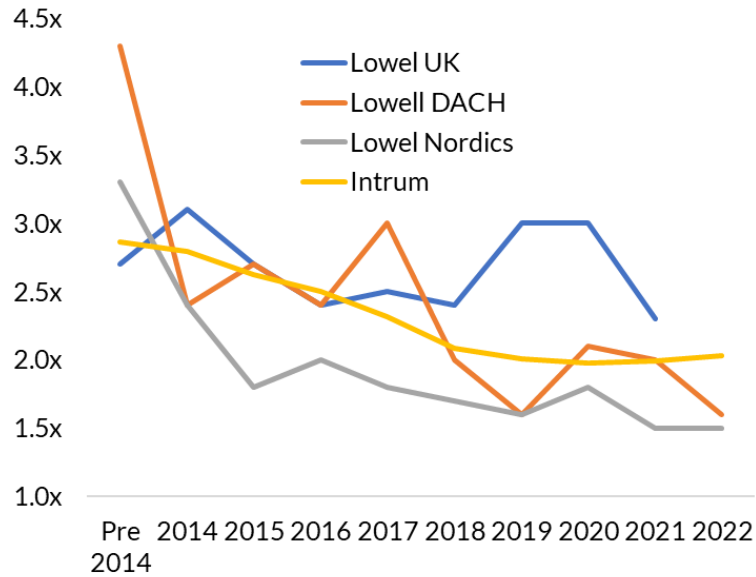
- Stage 2 loans and NPLs have moved in opposite directions.
- NPL ratios trended downwards to just under 2% - stimulus, household savings, loan moratoria.
- Significant hindrance to pricing, as banks remain main originators.

## Intrum ERC by Industry

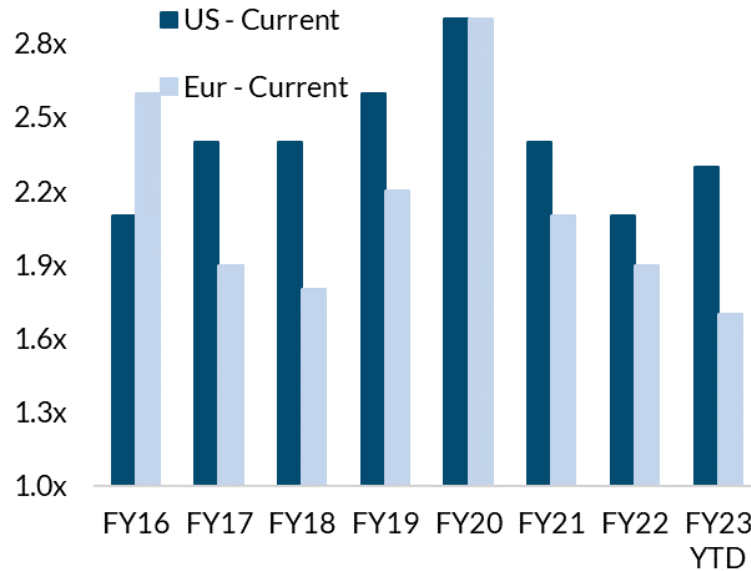


# Profitability Under Pressure

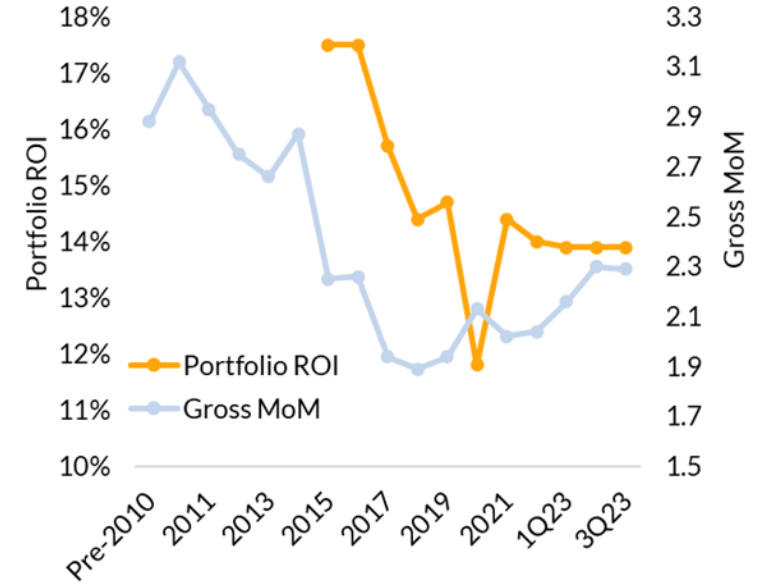
## Lowell: 120m GMM by Vintage



## Encore: Purchase Price Multiple



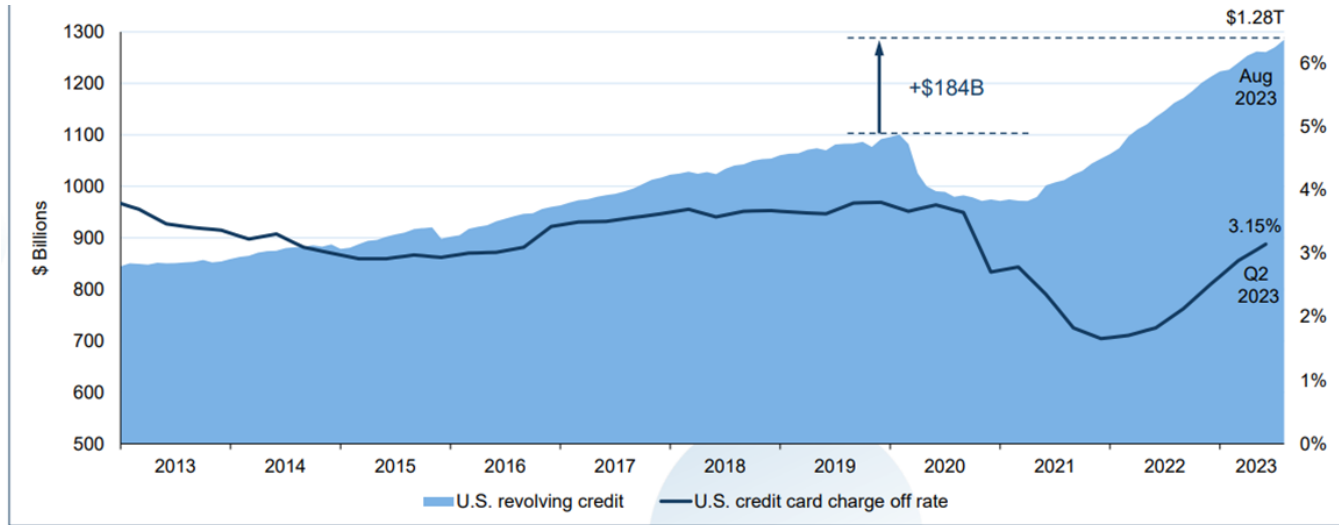
## Intrum: Unsecured GMM / ROI





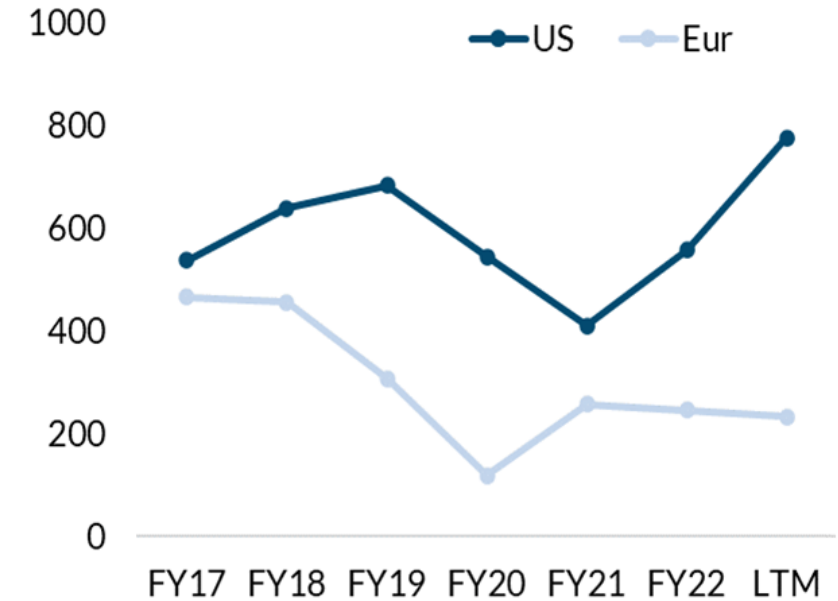
# Though US Markets Leads Recovery

## US Market Benefits from Improved Conditions



- US unsecured credit supply and charge off rates up from Covid lows.
- Capital allocation for Encore and lower purchases by Europe focused purchasers reflects market conditions.

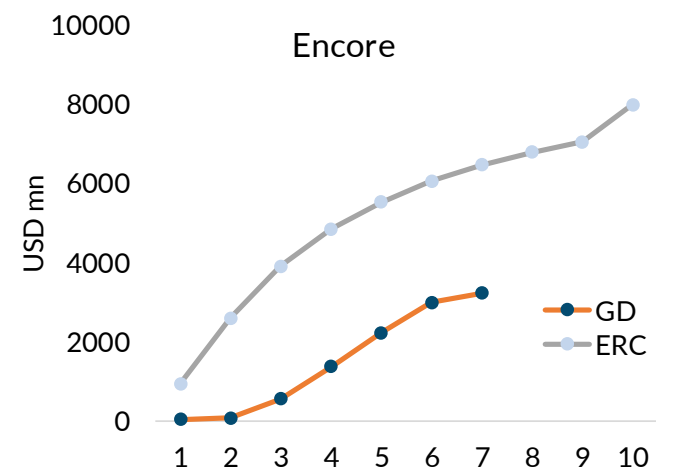
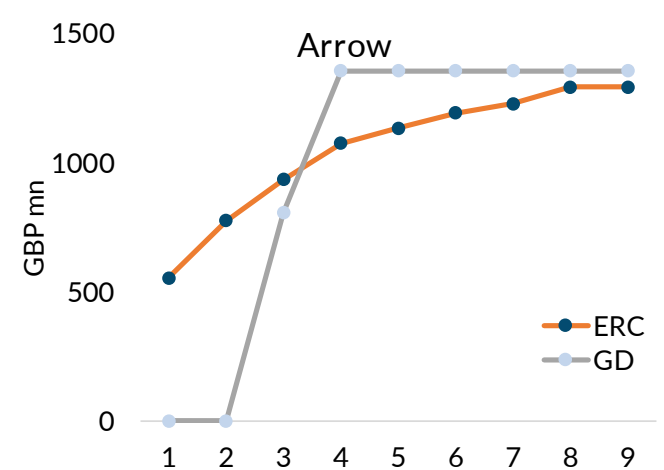
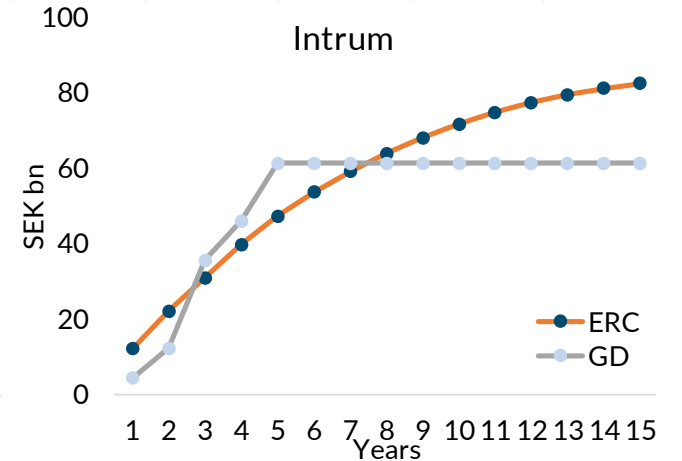
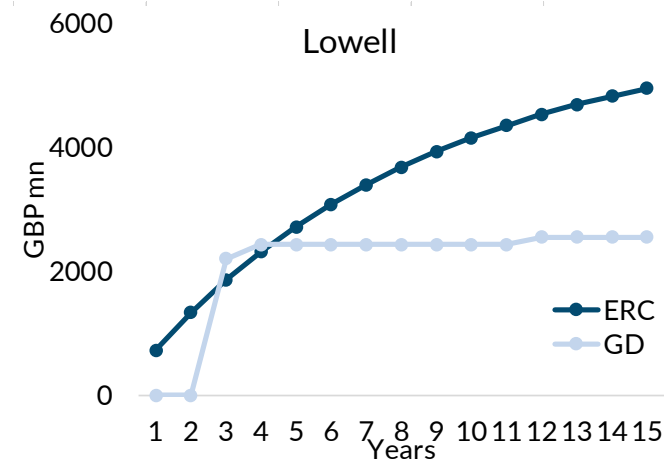
## Encore Portfolio Purchases – Europe vs US



# Escalating Maturities From 2025-26

## ERC Versus Debt Maturity (Cumulative)

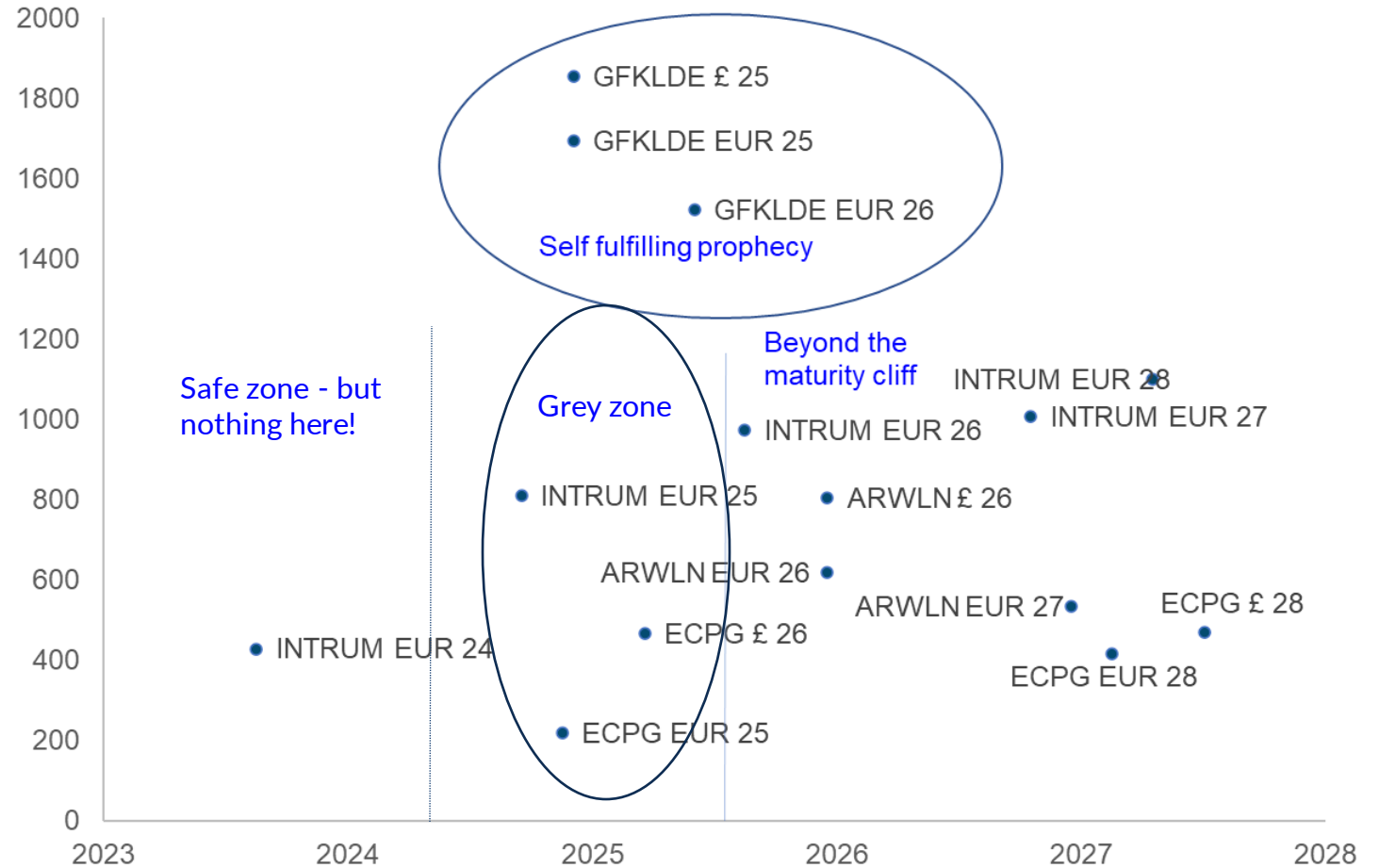
- ERC / backbook offers illusion of debt coverage.
- Funding for balance sheet: debt growth, free cash flow, equity.
- Backbook sales / shrink portfolio? Substantial unlockable book value, but not long-term fix.
- Equity? Not unless industry has a future.
- Servicing valuations - function of the state of market.



# Bond Maturity Wall From 2026

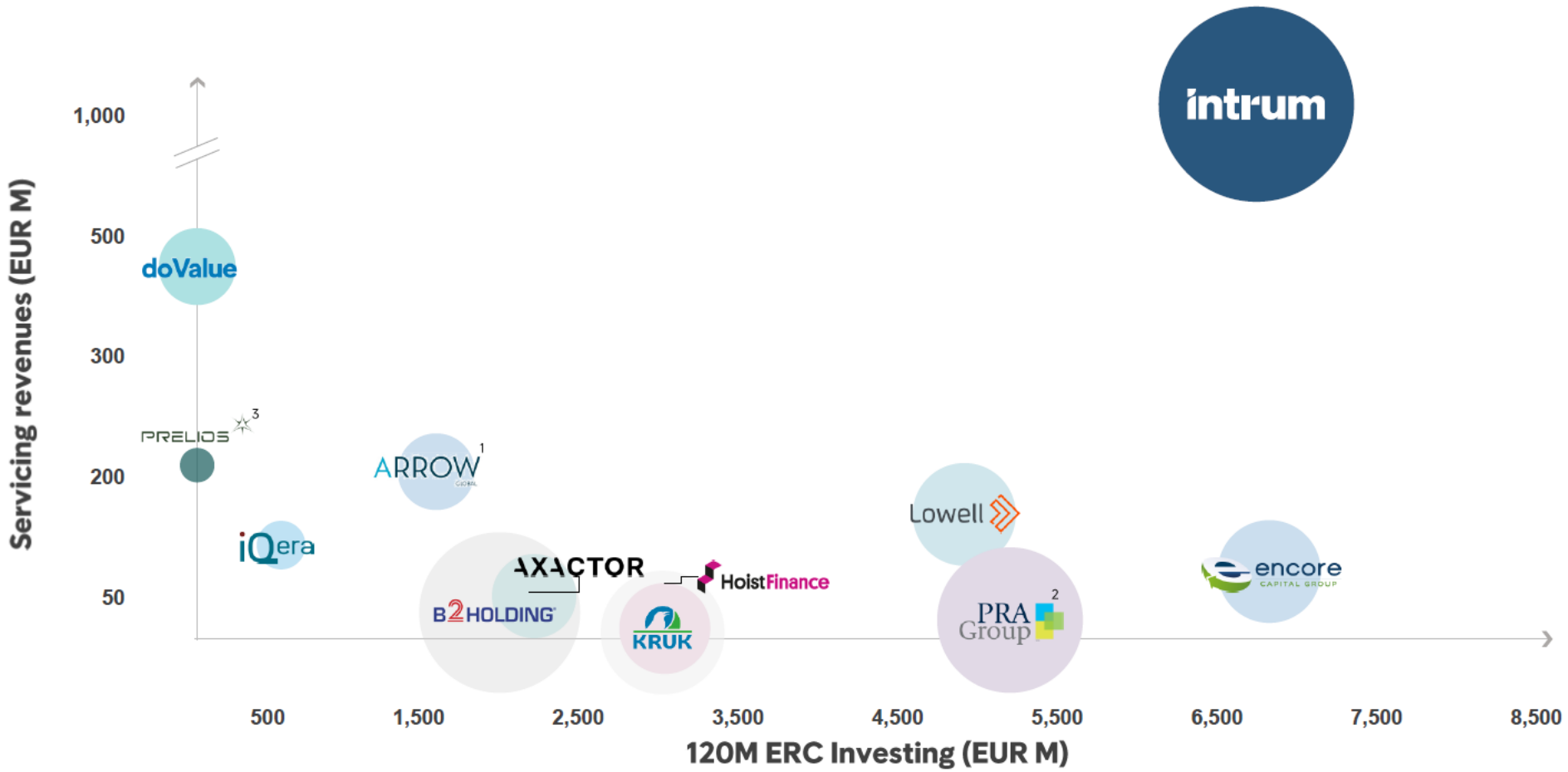
## Z Spreads Versus Maturity

- Risk gradation across curve?
- 23-24 safe , closer to 26s is where trouble lies, 26-28 recovery flat.
- Near dated bonds covered by liquidity horizon: INTRUM '24s.
- Double digit yields: self fulfilling prophecy.
- What about the in-between bonds?
- Recovery?



# Solution Lies in Refreshing Business Fundamentals

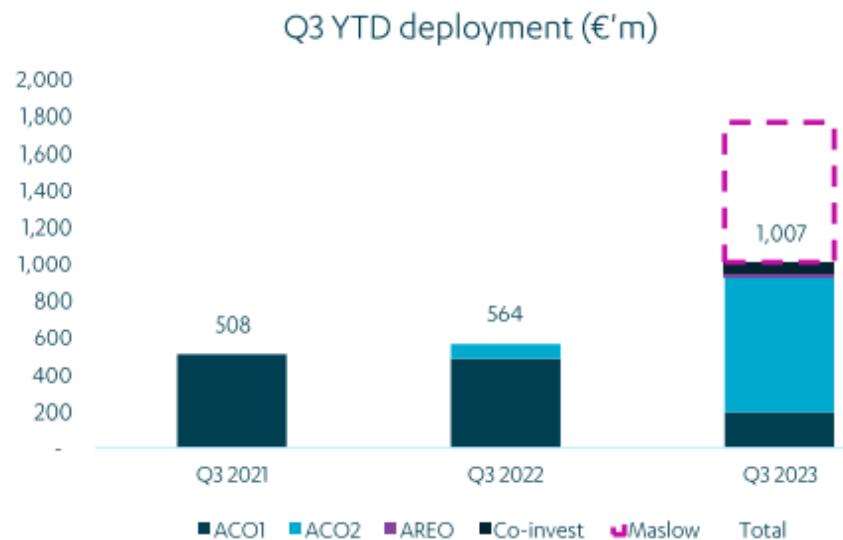
## Debt Collector Business Models



# Different Pathways, Common Theme: Scaling Back Balance Sheet

## Arrow: Integrated Fund Management

- ACO model: reducing co investment, as deployments ramp up.
- 2024 ERC bump offers buffer.



## Intrum: Revamping Servicing

- Scaling back portfolio purchasing.
- Fixing Servicing profitability.
- Extensive diversification a strength – in theory.
- Early days for co-investment strategy.

### Intrum's financial targets for FY26

	2Q20	2Q23	FY26E
Cash revenues	SEK 20.9 bn	SEK 24.9 bn	> SEK 24 bn
Cash EBITDA	SEK 11bn	SEK 12.8 bn	> SEK 12 bn
Discretionary cash flow	-SEK 2.8 bn	SEK 0.4 bn	2024-26: > SEK 16 bn
Net debt	SEK 49.7 bn	SEK 58.7 bn	~ SEK 40 bn
Leverage	4.4x	4.6x	< 3.5x
Investing BV	SEK 35 bn	SEK 41 bn	~ SEK 30 bn

# Conclusions

- Debt collector sector fundamentals and cash flow profiles remain weak.
- The sector faces a double whammy of escalating funding costs and declining profitability.
- Years of debt funded balance sheet expansion has caught up with issuers, and 2025 is the crunch point.
- Companies looking for creative ways to lighten balance sheet investing load but remains to be seen if fee income can replace portfolio management.
- Picks in the sector are those with conservative balance sheets (Encore) or well executed asset light strategies (Arrow).
- Exposure to US market positive (Encore), but promised expansion in European supply on hold, as NPL ratios plummet.

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