KAULKIN MEDIA

EXECUTIVE BRIEF
2nd Quarter Creditor and Agency Confidence Survey Report

Consumer Finance Sector Analysis Series

About Kaulkin Media

Kaulkin Media is the worldwide leader in providing timely news and information on the recovery of debt in all industries. We put the news in perspective, provide unique insight into challenges that face the industry, and facilitate collaboration among peer executives. Publications include www.insideARM.com®, www.jobsinsideARM.com™, *The ARM Insider*™, *Inside Card & Creditor Receivables*™, and other e-newsletters for the ARM (accounts receivable management) industry. Kaulkin's analyst group conducts sector-specific research that provides a level of authority and in-depth analysis not found anywhere else.

Kaulkin Ginsberg, parent of Kaulkin Media, is the leading strategic advisor for the ARM industry. For ARM service providers, our value-add services focus on analysis, growth, and exit strategies. For credit grantors, our focus is on optimizing receivables management strategies.

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"The second quarter 2008 Creditor Survey underscores the anxiety being caused by the current economic conditions as well as an increasing receptivity to the ARM industry's bad-debt solutions."

InsideARM's Confidence Survey of credit grantors reveals both a concern that the struggling economy could negatively impact consumer payment patterns and the belief that their service provider partners in the ARM industry will rally to improve performance over the next year.

Kaulkin Media recently launched a series of Confidence Surveys directed at creditors and debt collection agencies. The results from hundreds of responses are compiled in the data that follows, representing the combined perspectives of professionals in two creditor industries – financial services and healthcare – as well as those of professionals in the contingency collections market.

While economists and government regulators may continue to aurgue over whether or not the U.S. economy is in recession, regular Americans are acutely aware that eggs and milk cost more today than they did last fall, that ten dollars barely buys two gallons of gas, and that the job market has remained weak. The month of June saw an additional 62,000 jobs disappear, bringing the official unemployment rate to 5.5 percent.

Another key government benchmark, the Consumer Price Index – which measures inflation – increased by a higher than expected 1.1 percent during the month of June. This was above the 0.8 percent increase forecast by many Wall Street economists and marked the biggest monthly increase in inflation since 1982.

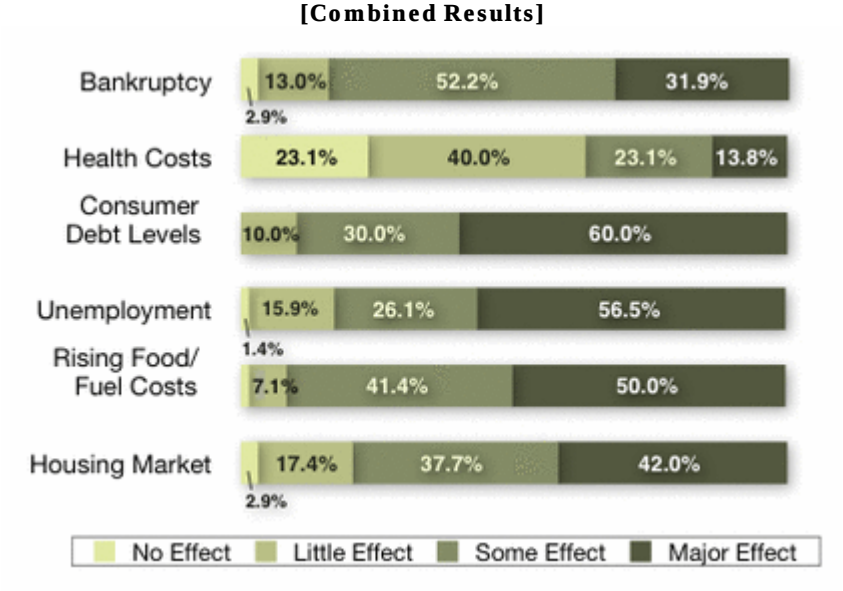
A recent Washington Post article on the clash between consumers' impressions of economic circumstances and the actual state of the economy argues that however great the disparity between individual impressions and the reality of the current financial crisis, public perception will nevertheless alter consumer behavior. For example, following the monthly announcement of negative employment figures, or an especially dismal week for the stock exchanges, consumers are more likely to assume the sky is falling even if they possess adequate job security and don't invest in the stock market. Pessimism about the nation's economy is likely to further constrain consumer spending and worsen an already bleak situation.

How the convergence of a mortgage crisis, increasing unemployment, and the continually rising costs of gasoline and food has weighed on consumers' minds and pocketbooks is important for credit grantors and ARM industry. Reductions in spending signal not only fewer new purchases, but tightened household budgets and lower rates of recovery for creditors and collection agencies.

I. How Macro-level Factors May Be Influencing Recoveries

We asked creditors how they view the impact on consumers of various macro-economic forces and what affect they are having on recovery rates.

Impact of Broad Economic Forces on Recovery Performance
[Combined Results]

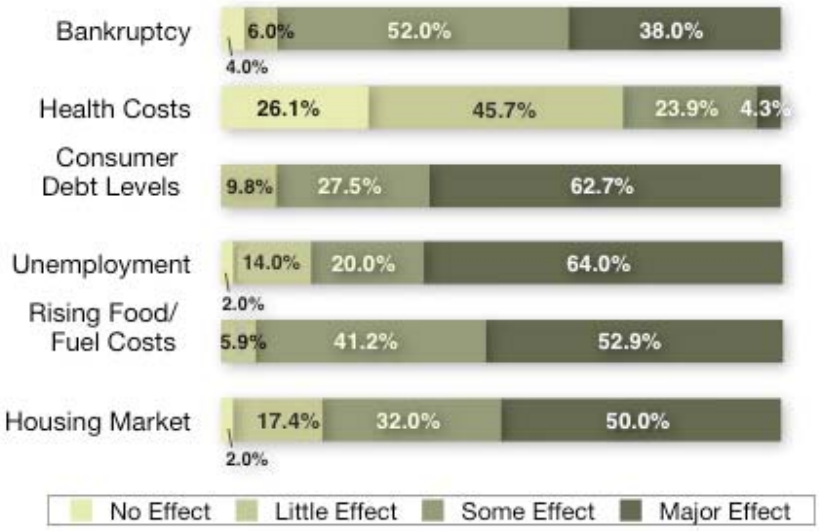


Among all creditors surveyed, a majority of participants – 60 percent – cite Consumer Debt Levels as having a "Major Effect" on their recoveries. Following closely behind are Unemployment and Rising Food/Fuel Costs, garnering 56.5 percent and 50 percent, respectively, as factors having a "Major Effect" on converting receivables into cash.

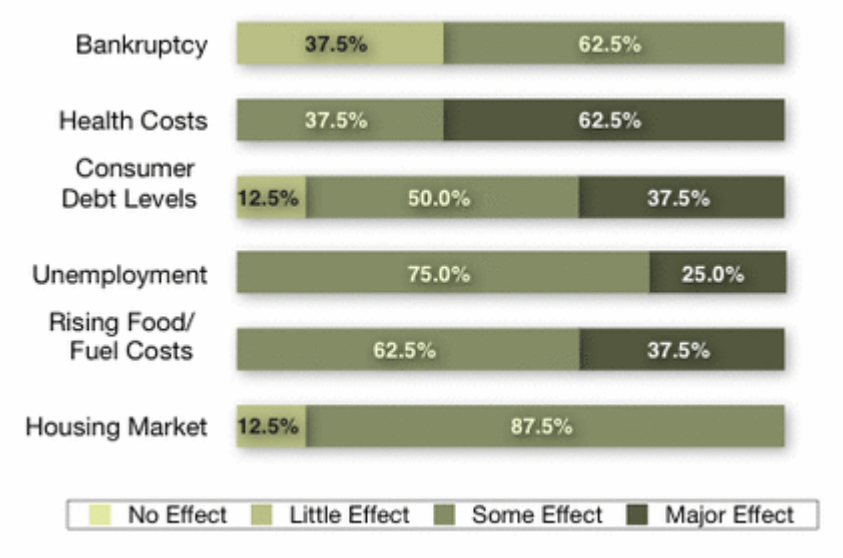
In all categories except Health Costs, the numbers corresponding to "Some Effect" and "Major Effect" are more or less evenly distributed when all responses are combined.

Not surprisingly, when financial services and healthcare creditor responses are viewed separately there is a noticeable shift in these distributions.

Impact of Broad Economic Forces on Recovery Performance
[Financial Services Results]



Impact of Broad Economic Forces on Recovery Performance [Healthcare Results]



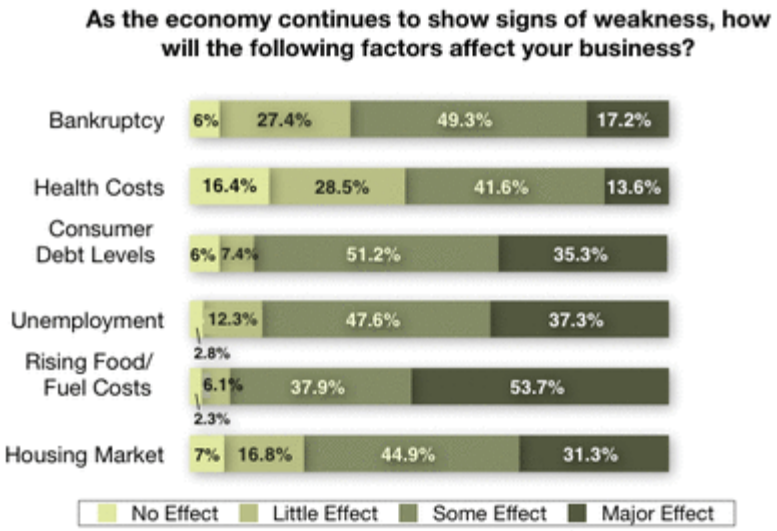
Health Costs is reported by 62.5 percent of healthcare creditors as having a "Major Effect" on recovery rates. The same percentage of the group views the threat of Bankruptcy as influencing recoveries, but only to the extent of "Some Effect."

Unique to financial services creditors, Bankruptcy was viewed as a much bigger concern with 52 percent perceiving "Some Effect" on recoveries and 38 percent perceiving a "Major Effect." The threat of Bankruptcy was perceived by 90 percent of financial services creditors as influencing recoveries when ratings of "Some Effect" and "Major Effect" are combined.

One factor indicated by an overwhelming majority of healthcare creditors as influencing recoveries is the Housing Market, with 87.5 percent perceiving the housing slump as having "Some Effect" on their recovery efforts. Conventional wisdom holds that increases in healthcare expenses are directly related to deteriorating recovery rates for hospitals and physicians, and therefore would be the most important factor for recovery rates in the healthcare industry. But it appears the broad reach of the housing crisis is seen as nearly as significant by healthcare creditors as a group. For Americans struggling to save their homes from foreclosure, credit card and hospital bills are seen as occupying a lower position on the totem pole of financial priorities.

The financial services creditor group perceives Consumer Debt Levels, Unemployment, Rising Food/Fuel Costs, and the Housing Market as "Major" threats to recoveries. Specific to the Housing Market, 82 percent of this group perceives an influence of either "Some Effect" or a "Major Effect" on their recovery efforts. 23.9 Percent of the group views Health Costs as having "Some Effect" on recoveries, while 4.3% believe it has a "Major Effect".

The perception of what economic factors most impact the collectability of outstanding debt for collection agencies aligns closely with the views held by financial services creditors.

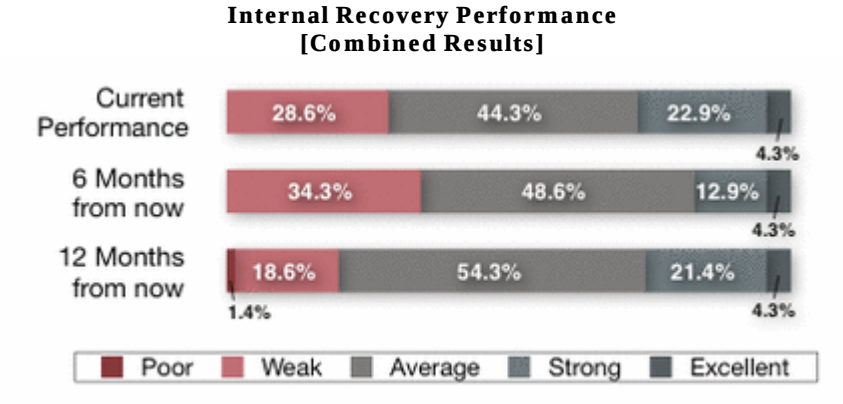


The most concerning factor for collection agency executives is the influence of Rising Food/Fuel Costs, the only factor for which a majority – 53.7 percent – report a "Major Effect" on recoveries. When combined with perceptions of "Some Effect," 91.6 percent of this group said Rising Food/Fuel Costs is influencing their collection efforts, the highest response rate of any factor. Consumer Debt Levels are also viewed with concern as 86.5 percent of collection agencies report debt levels are having either "Some Effect" or a "Major Effect" on recoveries.

With good reason much has been made of the impact these factors are having on the consumer and the economy. For creditors, these factors have added to the difficulties of collecting outstanding debts; bad news as charge-offs and delinquencies across a broad spectrum of consumer credit products have continued to climb this the year.

II. Perceptions of Internal Recovery Performance

Though creditors indicate concern about the impact of Bankruptcy, Unemployment, and Consumer Debt Levels, the results of the Confidence survey show that our respondents' internal recovery efforts have yet to be affected as adversely as initially presumed.



Among all creditors surveyed, none characterize their current internal recovery performance as "Poor," and only 28.6 percent said they considered current performance "Weak." Over 44 percent of creditors characterize their current performance as "Average," and a surprising 23 percent of this group perceives their internal recovery performance as "Strong," even in the face of current economic conditions. Overall, 71.5 percent of creditor respondents viewed current internal

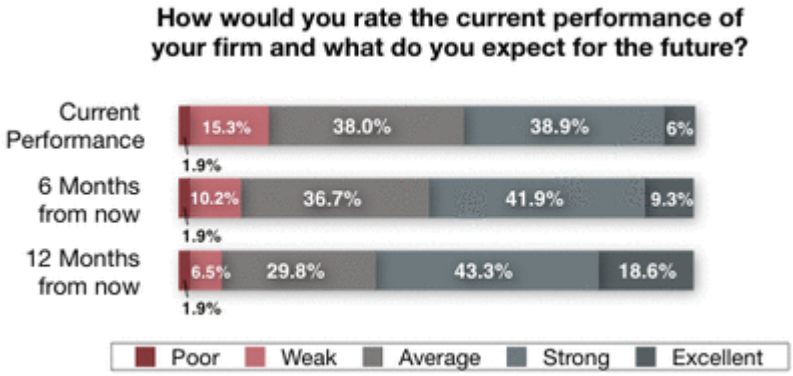
recoveries as either "Average," "Strong," or "Excellent," standing as testament to the increasing emphasis being placed on receivables management.

Nearly half of all creditors – 48.6 percent – still expect "Average" recovery performance six months hence, though respondents expecting "Weak" performance increased to 34.3 percent from 28.6 percent for that timeframe. This increase in creditors expecting "Weak" performance suggests that recovery efforts in the midterm will prove difficult for an increasing number of institutions.

The survey reveals that midterm creditors expect performance to be shaky, but also reveals the majority of respondents view long-term internal recovery performance in a more favorable light than economic headlines would otherwise suggest.

More than half – 54.3 percent – of creditors view their long-term internal recovery performance in positive terms and indicate performance will remain "Average" twelve months hence. This is up from the 48.6 percent who expect "Average" performance six months from now. The number of creditors expecting performance to be "Poor" saw a decline from 34.3 percent to 18.6 percent. Those expecting "Strong" performance saw an increase from 12.9 percent to 21.4 percent, showing 80 percent of creditors expect recoveries to be "Average" or better by summer 2009.

For collection agencies, there is some concern over current recovery performance, but overall this group is generally upbeat in its view of current and future performance.



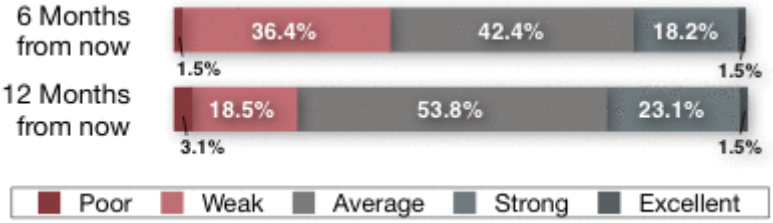
Though a combined 17.2 percent of collection agencies see current company performance as either "Poor" or "Weak," 38.0 percent report current performance as "Average," while 38.9 percent of collectors report current performance as "Strong." An additional 6.0 percent of collectors reported current performance is "Excellent," for an overall "Average/Strong/Excellent" rating of 82.9 percent exemplifying the positive attitude held by the group.

Looking into the first half of 2009, the number of collection agencies expecting positive recovery performance increased with a combined 41.2 percent predicting either "Strong" or "Excellent" performance six months from now, and 61.9 percent predicting the same this time next year.

III. Perceptions of Service Provider Recovery Performance

Similar to their internal recovery performance, creditors who outsourced parts of their receivables management report more optimism about the future performance of their service provider partners than current economic conditions suggest.

Service Provider Recovery Performance
[Combined Results]

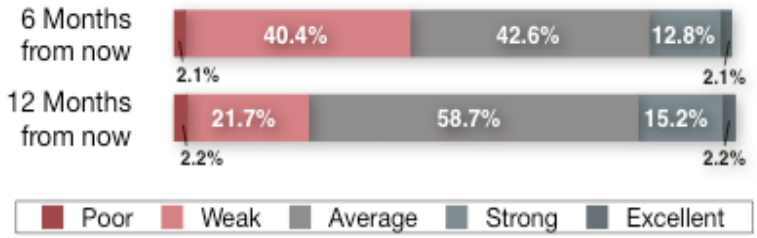


Among all creditors surveyed, 42.4 percent expect recovery performance from their service providers to be "Average" six months from now, although more than 36 percent of the group expect "Weak" performance in that period. Over 18 percent of creditors expect their service providers to have "Strong" performance for this timeframe, indicating some creditors have already begun to modify recovery strategy to contend with the current economy. The extreme ends of service provider performance, both "Poor" and "Excellent," account for a scant 1.5 percent each.

For the period twelve months from now, expectations of increased stability prevail with 53.8 percent of creditors expecting the performance of their service providers to be "Average," an increase of 11.4 percent from the six month total. Additionally, creditors expecting the performance of their service providers to be "Weak" decreases from 36.4 percent to 18.5 percent, while those expecting service provider performance to be "Strong" increases 18.2 percent to 23.1 percent. In total, 78.4 percent of creditors expect service provider performance to be "Average" or better one year from now.

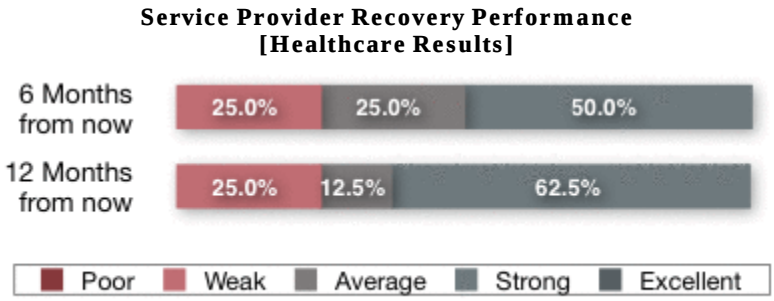
When segmented to isolate financial services and healthcare creditor viewpoints, a higher level of optimism about anticipated service provider performance emerged from the perspective of healthcare respondents.

Service Provider Recovery Performance
[Financial Services Results]



Specific to the financial services creditor group, a more conservative outlook is apparent. For the period six months hence, 40.4 percent of financial services respondents predict "Weak" recovery performance from their service provider partners, a sharp contrast to the healthcare-specific response of 25 percent.

Though more than half of financial services respondents predict that the performance of their service providers would be either "Average" or "Strong" six months from now, the 55.4 percent figure is still well below the 75 percent of healthcare creditors holding the same view.



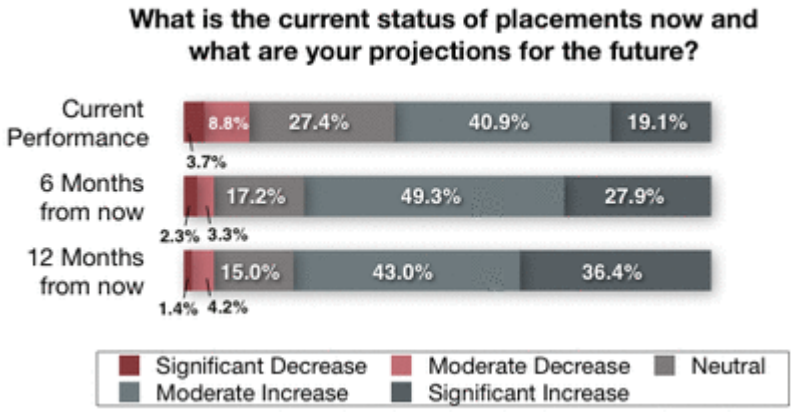
For healthcare creditors 25 percent predict "Weak" recovery performance from their service providers in both the six and twelve months hence period. But that is evened out with another 25 percent of the group that predict "Average" performance six months from now. That prediction of "Average" performance drops to 12.5 percent in the 12 months hence period, but the balance is absorbed by respondents predicting "Strong" recovery performance, which increases from 50 percent to 62.5 percent by mid 2009.

For the period 12 months from now, the outlook of financial service creditors aligns more closely with those of the healthcare creditor group, though with a more muted optimism. Financial services respondents predicting "Weak" recovery performance witness a 46 percent decline from the six months to twelve months hence period falling from 40.4 percent to 21.7 percent, while the portion of this group predicting "Average" performance increases nearly 38 percent to 58.7 percent of respondents.

Comparing the segmented and aggregate data for credit grantors shows that healthcare creditors hold a sunnier view of their service providers' performance in collecting delinquent accounts. In itself, this finding reveals that the financial services industry, which has suffered greatly during the current economic turbulence, continues to be concerned with overall recovery performance.

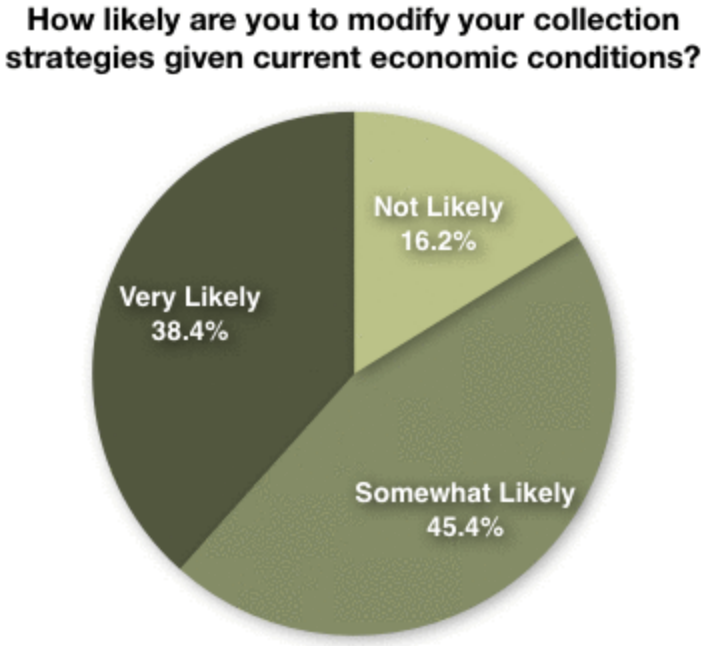
IV. Specific to Collection Agencies

For collection agencies, an effect of rampant consumer debt levels and deteriorating debt portfolios has been an uptick in accounts placed with agencies for servicing.



Sixty percent of collection agencies report a "Moderate" or "Significant" increase in placements, while only 12.5 percent said that placements have decreased "Moderately" or "Significantly." The rest of the group reports no change. There is optimism for the future of placements as well, with a combined 77.2 percent of collection agencies expecting placements to rise "Moderately" or "Significantly" in the next six months and 79.4 percent predict a similar increase 12 months from now.

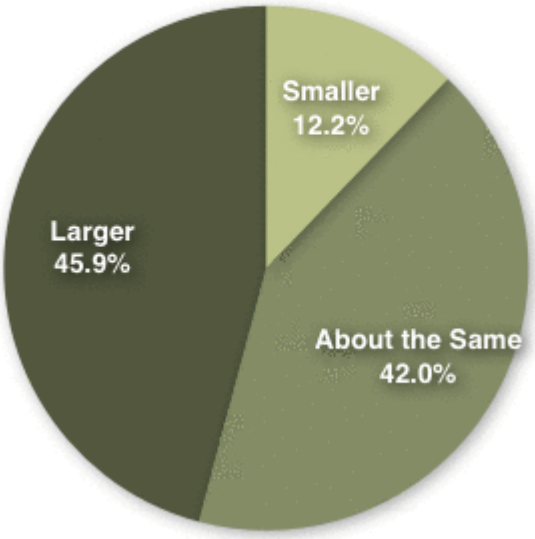
For collection agencies, the impact of current economic conditions on collections strategies was another important question.



When asked how likely they were to change strategies, 38.4 percent of collection agency respondents said that it is "Very Likely" they would change their strategies, with another 45.4 percent saying it is "Somewhat Likely." Only 16.2 percent report that it is "Not Likely" that they will change collection strategies.

Another good gauge of a company's true performance and health is payroll growth. Quite a few collection agencies within our survey were planning to grow this year despite the difficult economy.

Do you expect the size of your staff to be smaller, greater or about the same six months from now?



A strong 45.9 percent say they will be larger in six months as a response to this question, while another 42 percent report that things will stay the same. Only 12.2 percent of collection agencies expect to have a smaller staff in six months.

To conclude our Second Quarter 2008 Creditor Confidence Survey, we ended with an open-ended question. We asked respondents, "What are some other challenges and concerns that you see on the horizon for the accounts receivable management industry?'

We received many responses but have included the ones we found most interesting, and hope to address in our subsequent surveys:

- "I hope to see more debt bought by our law firm as the price of debt goes down and we will do well"
- "Increasing federal regulation"
- "Mainly the availability of qualified workforce is lacking"
- "Spend more to collect less"
- "Greater legal risk – as times get harder people are looking for law suits"
- "Collectors as a whole will need to adjust their collection style from BIF and SIF to a more PPA oriented approach. Although BIF or SIF are the obvious primary goals, gone are the days of the readily available refinance as a talk off strategy. The collectors who have long been at the lower end of the commission scale due to a weaker talk off can now begin to pull closer to the top producers because their style fits in with the consumers current abilities."