

Interview with PIOTR KRUPA, CEO of the debt collection firm Kruk, by Przemysław Tychmanowicz

CJEU rulings are a source of opportunities rather than threats to Kruk

This year appears to be challenging for Kruk. Your net profit for the first nine months is down year on year, investment expenditure has been falling and the stock price development is not exactly a cause for optimism, either.

Let us start with that last statement. If we look at our major industry peers listed on global exchanges, a downtrend can clearly be seen. Investors view the industry differently than they did only three or four years ago. Kruk has been sliding down together with its peers. Obviously, the stock performance could be better if the results were better. Earnings give a natural boost to the stock price. At any rate, I believe that the stocks of debt collection companies are not likely to experience any further major declines. Just the opposite, I think they are more likely to rebound. Debt collectors are making profits but expectations have been too high. And let us be fair, the weakness of the Kruk stock reflects the recent weakness of the entire capital market in Poland. The dust has not yet settled on the GetBack disaster. So, we are dealing with a number of factors that have influenced today's price of Kruk shares.

Has what happened to GetBack and its ramifications had an impact on your business?

I certainly expected more transactions on the domestic market this year. But I was wrong. There are a host of factors that should theoretically prompt banks to sell their debt ledgers. Lending activity is at its peak. Loss rates may be relatively low, but there are lots of portfolios banks should be looking to sell because managing them is increasingly costly, prolonged and demanding, partly as a result of new regulations imposed on the market. There are also CJEU rulings that may cause banks to post lower earnings and increase provisioning, which could push them to sell their debt accounts. In my opinion, this is the best time in twenty years to sell NPLs.

Why then is the supply of bank debt relatively low?

I think banks assume they will be able to sell debt at a predetermined target price. But the market was distorted in recent years, and now you cannot sell portfolios at prices one of the debt collection firms offered only a while ago. Banks are biding their time though, waiting for higher prices to return. In my opinion, this will not be the case. On top of all that, there is the statute of limitations. The longer banks hold on to their debt portfolios, the less time will be left to recover the debt, which will further impact the prices. Another thing is that banks may rely on models that underestimate NPL provisions. If so, larger provisioning will be needed for subsequent portfolios. We are in a state of suspension right now, but I believe 2020 will mark a turning point. Of course, banks may try to collect in-house but they cannot do that as cost-efficiently and successfully as we can.

Now that GetBack is out of the market , international credit management companies seem to be your main competitors.

Kruk has been competing with large international players for a long time now and I don't expect this to change. Smaller firms operating in Poland are struggling with their own problems, as they have purchased debt portfolios at higher prices and now need to face the music. I would like to stress here that our ambition is not to win every single auction. Our objective is to purchase some 20%-25% of the debt portfolios put out for sale in Poland. What is important, the margins generated on new investments seem to be converging with those on global markets. While the prices may not be falling, we are back to normal after a time of turbulence. In 2020, we should be down to brass tacks again. We are going to purchase debt on the Polish market as it will offer more transactions, and we are well positioned to do so, both organisationally and financially.

New regulations are being enacted. You also mentioned judgments of the Court of Justice of the European Union. What impact might they have on your business?

Naturally, we will closely monitor the effects of CJEU judgments on the banking sector. In my opinion, those banking clients whose agreements contained abusive clauses, and who took out loans when the CHF/PLN exchange rate was 2.10-2.73, will seek to have their agreements nullified. This, of course, would be costly for banks, and they might start seeking new sources of income, including through sale of debt portfolios.

And what about the foreign currency loan debts you have purchased?

Firstly, such debts account only for a minor part of total debt cases we have purchased. Foreign currency-denominated consumer and corporate mortgage debt represents just 3% of the PLN 7.1bn we expect to recover. Secondly, and more importantly, final court judgments with respect to most of these cases have already been awarded in favour of Kruk and cannot be appealed against. Moreover, no petition may be filed with a court to invalidate an agreement based on which another court has already issued a judgment. No court may reverse a final ruling of another court – according to the “res iudicata” principle. It is mainly for this reason that the risk of our performance being adversely affected by foreign currency corporate and retail mortgage debts combined is below 0.5% of Kruk's total expected recoveries over at least the next ten years. Therefore, we are not directly affected by the CJEU judgments. I don't understand comments claiming that such judgments could materially affect Kruk's business. It is simply not true. Instead, they may give rise to increased supply of debt portfolios as banks, recognising larger provisions for CHF-denominated mortgage loans, will post lower profits. This, in turn, will affect their capital structures, ability to pay dividend, and may ultimately prompt them to sell their debt accounts. The CJEU's second judgment, the one concerning the fee refund, may also pose a serious problem to banks, which again is likely to boost debt portfolio supply. Also in this case, there is clearly no direct impact on Kruk's business.

Your business is also affected by other regulations, such as those pertaining to the already mentioned limitation period or court enforcement officers. Are they not a problem?

These regulatory changes have not come out of the blue. In fact, we have been preparing for them for years. In the case of the statute of limitations, we have been introducing internal changes to avoid any unpleasant surprises. We did not like the idea of taking on the limitation risk. And besides, generally speaking, I think this is a change for the better. I had been waiting for this issue to be regulated for some two decades. In my opinion, this amendment will boost our business, as banks will no longer be able to interminably postpone the sale of debt.

Now, the amendments relating to court enforcement fees apply in the same way to all secondary creditors. They will be priced into any future portfolios we will buy. Actually, for several quarters now we have included the higher debt servicing cost in our valuations. A separate issue is what is known as “service by default”. I think it is too early to consider any negative scenarios here. Quite the contrary, everybody expects the new law to be of some help. If someone fails to collect correspondence, a court enforcement officer will visit them in person. It is hard to imagine people hiding from court enforcement officers. Let me strongly emphasise that we prepare for all regulatory changes in advance. Therefore, they do not take us by surprise.

But the proposed amendments related to lending activity did come as a surprise, didn't they? Especially in the context of Wonga, which you recently acquired.

You are right, they did. When making a decision whether to buy Wonga, we analysed the draft anti-usury act. We assessed the proposed regulations as favourable, as they presented an opportunity to regulate the market and eliminate its pathologies. In fact, it was one of the factors that persuaded us to acquire Wonga. However, a self-amendment was announced later by the bill sponsors that changed the situation, proposing new limits for non-interest expense on consumer loans. A number of players on the market will not be able to cope under such legal regime. I hope this proposal will eventually be modified.

Had you known about it, would you have bought Wonga?

We would have probably waited for the matter to be finally resolved. Business needs a predictable environment. Wonga is a very good company. Already in September, it was above the break-even point. This proves that the business is sound, but, of course, there are natural questions about the future. If the amendments are actually enacted, we want to be prepared for them.

This year Kruk has been facing a series of challenges on foreign markets, too.

We have determined to adopt a very selective approach to investments on foreign markets. We are focusing on our existing assets, seeking to constantly improve operating efficiency. This approach is expected to bear fruit in the coming years. Frankly, the risk that has materialised in our foreign markets was greater than we originally expected. This is a lesson for us to act on the market with more prudence, which will certainly pay off in the future.

When do you expect a breakthrough moment for your foreign operations, particularly in Italy?

I thought 2019 would be that moment, but it wasn't. But I am confident that next year will be much better. The Italian market is more difficult than we thought, and we paid the price in impairment losses. The price we are paying now is lower investments, which are much more selective and managed to minimise the risk. I hope our work and lessons learnt will produce good results in 2020.

Financing is key in your industry. You have opened a public bond programme. Will you issue any bonds this year?

It's unlikely. We are effectively managing our finance sources. We have strong investment and capital raising capacities should any interesting opportunities come up.

To sum up - will 2020 be a better year for Kruk?

We will surely continue to maximise profitability, which means an increased focus on the quality of investments rather than their number. In the event of a major economic slowdown, banks may be more inclined to sell their debt portfolios. To do so, they will need reliable partners with access to financing. We meet both these conditions.

On the other hand, any major deceleration of the economy could have a negative impact on recoveries...

Obviously, it could harm recoveries, but the scale and timing of any such slowdown are still uncertain. The projected recoveries of PLN 7.1bn are a conservative estimate, and I personally believe the actual figures may come as a positive rather than a negative surprise.

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Piotr Krupa is a legal counsel. In 1996, he graduated from the Law and Administration Faculty of the University of Wrocław. In 1997-2000, he completed judicial training, followed in 2000-2003 by legal counsel training. With Kruk since its inception, he was among the company's founders and has served as its CEO since 2003. Kruk was first listed on the Warsaw Stock Exchange in 2011. Mr Krupa continues to hold equity interests in the company.