Lucerne Investment Partners

# LawFinance Limited (ASX: LAW)
## Capital Reorganisation Summary
## December 2019

## Background

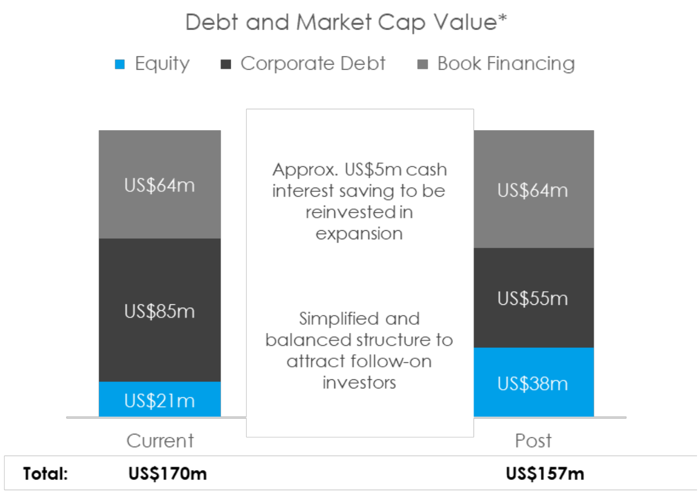
- LawFinance ("LAW" or the "Company") is a diversified financing business that specialises in personal injury funding in both the U.S. and Australia.
- LAW's 100% owned U.S. subsidiary, National Health Finance ("NHF"), finances healthcare expenses for not-at-fault victims of predominantly automobile accidents, providing an essential service to those that are underinsured or have poor healthcare cover.
- The lack of universal healthcare system (eg Medicare) in the U.S., results in a significant number of accident victims being unable to afford the essential medical care they require – **NHF solves for this**
- The Company has been constrained by a stretched balance sheet and is undertaking a capital reorganisation that will see the Company funded to meet current demand and further U.S. expansion.
- The reorganisation will be comprised of the conversion of ~A$46 million of debt into equity and options and an underwritten A$12.5 million injection of fresh equity capital via a placement and non-renounceable rights issue.
- LAW will be cashflow positive upon completion of the reorganisation and well capitalised to exploit the $US15.8 billion addressable market in the U.S.

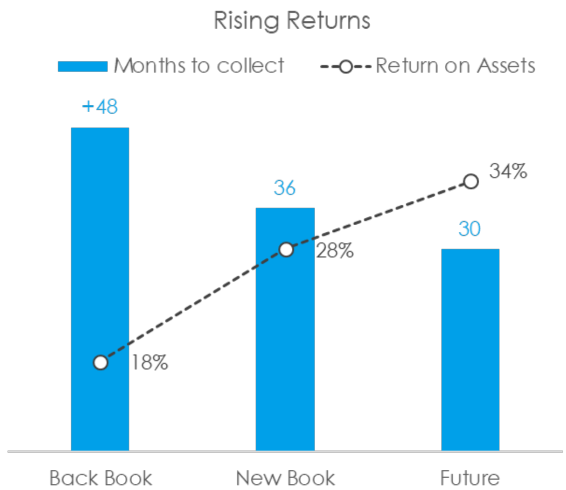
## Investment Highlights

- ✓ **Cashflow positive post-transaction**
- ✓ **Large US$15.8 billion addressable market (see industry overview)**
- ✓ **Capital raising to fund growth of established business**
- ✓ **Current ROA of 23% p.a. estimated to grow to 34% p.a. within 18 months**
- ✓ **20-year operating history**
- ✓ **Experienced management team**

## Balance Sheet Improvement

- Several existing debt holders have agreed to convert to equity and options to immediately improve the balance sheet and allow the company to grow - **approximately A$46 million of debt will be converted to equity and options.**
- Seeking A$12.5m ($US8.5m) in new equity capital to provide working capital to fund growth in new loans – existing shareholders have underwritten the raising.
- New investors will be offered equity on the same terms as existing subordinated debt holders who are converting into equity.

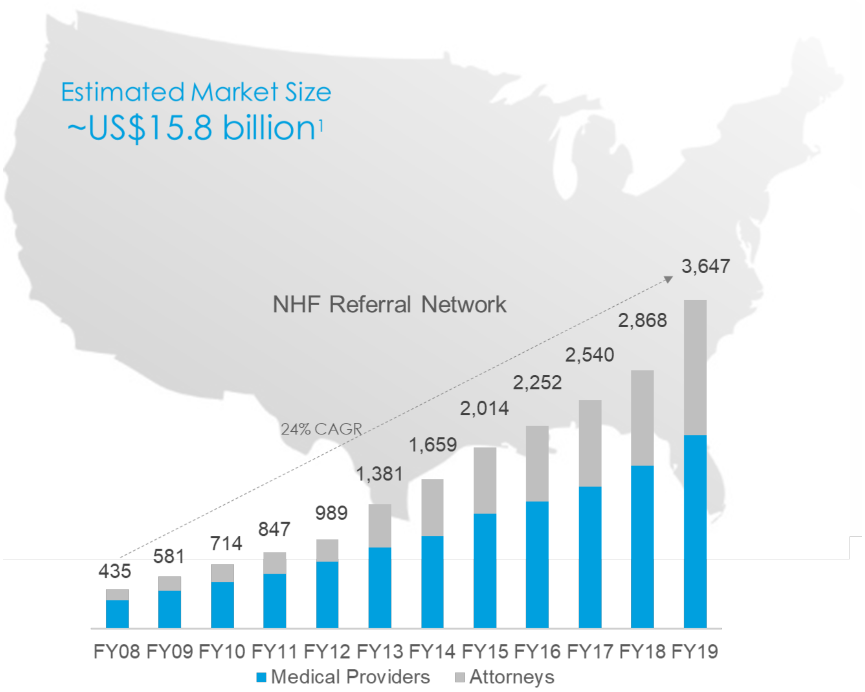



*Market cap value assumes equity price of 6.4c.

# Industry Overview

**NHF currently funds less than 1% of the total addressable market and has the internal infrastructure and a relationship network to grow to +5% in the years ahead.**

- NHF has been operating for 20 years and is the fifth largest personal injury financier in the United States.
- NHF operates in a large addressable market created by an underfunded and complex US healthcare system.
- The investment in technology architecture has allowed management to harness its referral network of +3,600 medical specialists & attorneys and more effectively manage its receivables book
- After a year of investment, access to more capital is required to capture the funding opportunity.




- The US healthcare market is inefficient – it does not have our version of Medicare. This allows financiers to earn excess returns on capital by bridging the time gap between when patients require treatment to the time it takes for the insurer to pay for the treatment.

## What problem does NHF solve?

The lack of universal healthcare system (e.g. Medicare) in the U.S., results in a significant number of accident victims being unable to afford the essential medical care they require

### Medical Providers Benefit

- Allows the physician to focus on patients
- Ensures timely payment to medical providers

### Attorneys Benefit

- Assists attorneys to obtain medical care for clients
- Removes "gap in care" from delayed treatment which can be used to minimise payout of the victim's claim.
- Assists with maximising the victim's claim.

### Patients Benefit

- Provides the victim with a level of medical care they would likely not otherwise receive.
- Avoids delays in obtaining medical care.
- Provides the victim with the opportunity to achieve improved compensation under their claim.
- NHF enables the patient to access premium care without the need for personal insurance coverage.

[1]estimated market size– 2.35 million injured in car accidents per year (50% at fault) + 8,000,000 "slip and fall" accidents per year which of which 5% meet funding requirements times an average claim size of $10,000. Source: Adidem Law.

# Growth Catalysts

We view the potential growth catalysts for the stock as the following:

**Immediate Funding Opportunities; Book Performance and Scale**
There are immediate financing opportunities in excess of US$25m that NHF will be able to fund upon completion of this capital raise. The paper is expected to deliver a ROA in the vicinity of 34% as per our sensitivity analysis. There has been a step-change in performance and productivity across NHF as management continues to replicate the success it has achieved with the Australian business.

**Refinance of the U.S. Warehouse facility**
The interest rate on the Atalaya facility is presently 13.5% and a key focus of the management team in the short-medium term will be reducing this cost. We expect a rate of 10% is achievable in the medium term for a secured book of this quality. The Australian management team has runs on the board in this area, having overseen the reduction in cost of its disbursements funding facility reduce from 13.5% when the facility was established, to its current rate of 8.70%.

**Realisation of Litigation Book**
We conservatively anticipate US$10m of cash will flow from the litigation funding book over the next 18 months. US$10m of equity injected into NHF's New Book would create significant value for LAW. If a conservative ROA metric of 25% is generated, the additional US$10m of equity has the potential to increase the NHF book by US$66m (assuming 85% LVR) and generate US$11m in free cashflow. Using an arbitrary 10x cashflow multiple, an additional US$100m in market capitalisation (US$110m minus the US$10m from the sale of non-core assets) is likely, in our view.

**ER Concierge Program**
The ER Concierge Program is designed to provide accident victims that are still within the acute phase of their injury with access to necessary Emergency Room quality care on a lien/letter of protection basis. This funding program is the first of its kind and is now live across multiple jurisdictions with further planned implementations across other states. To put this opportunity into context, if one hospital were to yield two patients per day at average ER invoice of US$7,000, this would lead to an additional US$5m in originations each year.

**Initiation of Broker Coverage**
There are currently no brokers that cover the stock. We believe the value for equity holders created by the proposed recapitalisation will attract broker interest to the stock.

Please turn over

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## Valuation – scenario analysis

- The NHF business model can be viewed as a funds management company - applying debt and equity capital and investing to earn a return in excess of the cost of this capital.
- The three key drivers of performance for all lending or funds management operations are as follows:
    1. Lending book performance
    2. Scale
    3. Cost of funds
- NHF currently generates a return on capital of circa 23% per annum. The problem is that the NHF book lacks scale - at less than $US100 million, the book is too small to support operating costs of $US7 million and current funding costs of 14%.
- The equity capital injection proposed will enable NHF to increase the size of its book, and lower funding costs (initially targeting 10%).
- This has the potential to see the equity of the company increase materially in value, enabling the company to continue to grow. We expect the return on assets to rise from 23% to 34% over the next 18 months - a function of improved asset turnover
- Upon execution of the proposed capital raise and balance sheet improvement, we estimate the stock to significantly re-rate based on the assumptions outlined in the scenario analysis tables below:

| Base Case – Loan Book US$130 million | |
|---|---|
| Receivables Book | US$130 million |
| Return on Assets[1] | 28% p.a. |
| Total Debt (75% LVR)[2] | US$98 million |
| Interest Costs | 10% |
| Operating Expenses | US$8 million |
| **Operating Profit** | **US$18.7 million** |
| **Valuation of NHF (10x Multiple)** | **US$187 million** |
| **Valuation of NHF (AUD)** | **A$277 million** |
| **Shares on Issue** | **1,015 million** |
| **LAW Valuation** | **AUD 27.3 cents per share** |
| Entry Price | AUD 6.4 cents per share |
| Equity Return | 326% |

| Bull Case – Loan Book US$250 million | |
|---|---|
| Receivables Book | US$250 million |
| Return on Assets | 34% p.a. |
| Total Debt (85%) | US$213 million |
| Interest Costs | 10% |
| Operating Expenses | US$12 million |
| **Operating Profit** | **US$51.8 million** |
| **Valuation of NHF (12x Multiple)** | **US$621.0 million** |
| **Valuation of NHF (AUD)** | **AU$918 million** |
| **Shares on Issue** | **1,270 million** |
| **LAW Valuation** | **AUD 72 cents per share** |
| Entry Price | AUD 6.4 cents per share |
| Equity Return | 1,030% |

***Note: The above tables represent example scenarios only and do not represent forecasts for NHF***

[1]Improved ROA between Base Case and Bull Case is due to the application of a blended ROA between "New Book" and "Back Book". Current originations are commanding an ROA of 34% p.a.

[2]Reflecting LVR of current senior secured finance facility. Bull case scenario assumes a new finance facility with an improved LVR of 85%.

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