

14 February 2018

## IMF Bentham Limited (IMF)

**BUY**

**Share Price: A\$3.16**

**Accelerating the transition to SPV funding**

**Target Price:**

**A\$3.72**

IMF Bentham's decision to accelerate its transition to the new SPV funding model by selling the majority of its US investment portfolio to Fund 1 is positive for two key reasons. First, it reduces IMF Bentham's capital intensity, with the company having received a cash payment for its capitalised investment net of its pro rata contribution to Fund 1. Second, assuming IMF Bentham can realise its historic success rate and ROIC on the transitioned cases, it will increase the return on the company's invested capital, while also bringing forward the point at which Fund 1 begins distributing residual profits, albeit at the expense of IMF Bentham's near-term reported earnings. This, in combination with the joint venture partners' collective decision to increase the size of Fund 1 to US\$166.3m, bodes well for the sustainability of the SPV funding model.

### Sale of US investment portfolio to an upsized Fund 1

- IMF Bentham has agreed to transfer all of its rights in relation to the majority of its investments in its US case portfolio to Fund 1 in return for a cash payment of US\$57.4m, of which US\$9.6m will be required to fund its pro rata contribution to the SPV. Concurrent to this, Fund 1 has also been upsized to US\$166.3m, with the potential for a further increase to US\$200m. The remaining US\$6.3m of capitalised US case investments will remain on IMF Bentham's balance sheet, with no further capital deployments expected.

### Earnings revisions

- Following the announced sale of the majority of IMF Bentham's US cases to Fund 1, we have revised our EPS estimate for FY18, FY19, and FY20 by -50%, -54%, and 131%, respectively. The key drivers are (i) increased cash inflows in 2H18, and (ii) deferment of earnings stemming from the US case investments that have been transferred to the SPV, which is required to pay priority returns (capital and income) before distributing a residual profit share to IMF Bentham. We have already assumed that Fund 1 reaches US\$200m.

### Investment view

- While IMF Bentham's accelerated transition to SPV funding increases the company's risk and return profile, it also provides the opportunity to optimise its balance sheet and reduce the capital intensity of future growth. With our estimated fair value for IMF Bentham having edged higher to \$3.72 per share, we remain favourably disposed to an investment in the company's shares on the basis that increased scale, improved funding and good risk controls will deliver an increasingly attractive and consistent rate of return for investors.

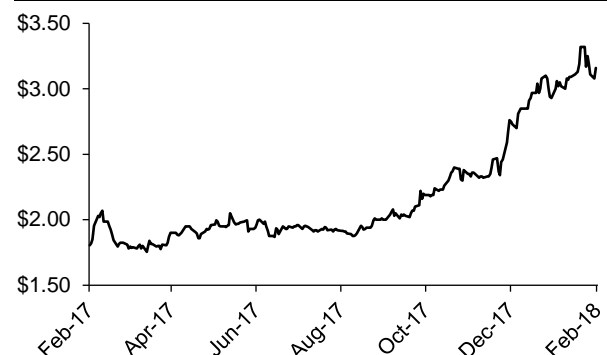
### Company Data

Shares – ordinary (M)	172.0
Dilution (M)	10.5
Total (fully diluted) (M)	182.6
Market capitalisation (\$M)	543.7
12 month low/high (\$)	1.74 - 3.33
Average monthly turnover (\$M)	20.3
Index	XFK
GICS Industry	Diversified Financials

### Financial Summary (fully diluted/normalised)

Year end June	2016A	2017A	2018F	2019F	2020F
Revenue (\$M)	53.0	54.1	55.0	92.3	105.9
Costs (\$M)	27.8	30.4	36.6	47.6	40.4
EBITDA (\$M)	25.2	23.7	18.4	44.7	65.4
NPAT (\$M)	20.8	15.4	15.8	35.4	51.6
EPS (¢ps)	11.6	8.5	8.7	19.7	28.5
EPS Growth (%)	138.6	-26.4	1.7	127.1	45.1
PER (x)	27.3	37.1	36.5	16.1	11.1
Free Cashflow (\$M)	-36.0	-51.9	-50.5	-58.4	-57.5
FCFPS (¢ps)	-5.7	-14.9	15.4	33.5	31.2
PFCFPS (x)	-55.6	-21.2	20.5	9.4	10.1
Enterprise Value (\$M)	510.8	555.8	477.2	431.8	401.5
EV / EBITDA (x)	20.3	23.4	25.9	9.7	6.1
Payout ratio (%)	60.6	77.5	59.9	59.1	60.5
Dividends (¢ps)	7.5	7.0	5.5	12.0	17.5
Yield (%)	2.4	2.2	1.7	3.8	5.5

### IMF – performance over one year



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This report must be read with the disclosure and disclaimer on the final page of this document.

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## Analysis

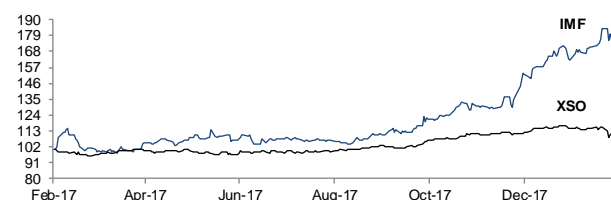
### IMF Bentham

Year Ending 30 June

#### MARKET DATA

Recommendation		Buy
Price	\$	3.16
Price target (12-month)	\$	3.72
52 week high / low	\$	1.72 - 3.16
Market capitalisation	\$m	543.7
Shares on issue (basic)	no.	172.0
Performance rights (probability weighted)	no.	10.5
Other equity	no.	0.0
Shares on issue (diluted)	no.	182.6

#### 12-MONTH SHARE PRICE PERFORMANCE



#### INVESTMENT FUNDAMENTALS

	2016A	2017A	2018F	2019F	2020F
Reported net profit	\$m 20.9	15.4	15.8	35.4	51.6
<b>Normalised net profit</b>	<b>\$m 20.8</b>	<b>15.4</b>	<b>15.8</b>	<b>35.4</b>	<b>51.6</b>
Reported EPS (diluted)	€ 11.7	8.5	8.7	19.7	28.5
<b>Normalised EPS (diluted)</b>	<b>€ 11.6</b>	<b>8.5</b>	<b>8.7</b>	<b>19.7</b>	<b>28.5</b>
...Growth	% 138.6	(26.4)	1.7	127.1	45.1
<b>Normalised diluted PER</b>	<b>x 27.3</b>	<b>37.1</b>	<b>36.5</b>	<b>16.1</b>	<b>11.1</b>
Operating cash flow per share	€ (19.4)	(28.0)	(27.3)	(32.1)	(31.4)
Adjusted free cash flow per share	€ (5.7)	(14.9)	15.4	33.5	31.2
<b>Price to free cash flow per share</b>	<b>x (55.6)</b>	<b>(21.2)</b>	<b>20.5</b>	<b>9.4</b>	<b>10.1</b>
Free cash flow yield	% (1.8)	(4.7)	4.9	10.6	9.9
Dividend per share	€ 7.5	7.0	5.5	12.0	17.5
Payout ratio	% 60.6	77.5	59.9	59.1	60.5
Yield	% 2.4	2.2	1.7	3.8	5.5
Franking	% 100.0	100.0	95.0	85.0	75.0
Enterprise value	\$m 510.8	555.8	477.2	431.8	401.5
EV/EBITDA	x 20.3	23.4	25.9	9.7	6.1
EV/EBIT	x 20.7	24.0	26.8	9.8	6.2
Price to book (NAV)	x 2.7	2.7	2.6	2.5	2.3
Price to NTA	x 9.6	41.8	5.5	4.3	3.8

#### KEY RATIOS

	2016A	2017A	2018F	2019F	2020F
EBITDA margin	% 47.5	43.9	33.5	48.4	61.8
EBIT margin	% 46.7	42.8	32.4	47.7	61.2
Underlying net profit margin	% 39.2	28.5	28.7	38.3	48.7
Return on average equity	% 10.7	7.6	7.6	16.3	22.0
Return on average assets	% 7.9	6.3	4.6	10.9	15.0
Net tangible assets per share	€ 32.9	7.6	57.4	74.1	83.6
Net debt/(cash)	\$m (58.0)	(21.1)	(99.8)	(145.2)	(175.4)
Interest cover (EBIT / net interest)	x n/a	n/a	n/a	n/a	n/a
Leverage (net debt / EBITDA)	x n/a	n/a	n/a	n/a	n/a
Gearing (net debt / net debt plus equity)	% n/a	n/a	n/a	n/a	n/a

#### DUPONT ANALYSIS

	2016A	2017A	2018F	2019F	2020F
Net Profit Margin	% 39.2	28.5	28.7	38.3	48.7
Asset Turnover	x 0.2	0.1	0.1	0.2	0.2
Return on Assets	% 6.1	3.9	4.1	8.5	11.5
Financial Leverage	x 1.7	1.9	1.9	1.9	1.8
<b>Return on Equity</b>	<b>% 10.3</b>	<b>7.5</b>	<b>7.5</b>	<b>15.8</b>	<b>21.1</b>

#### Revenue from litigation funding

	2016A	2017A	2018F	2019F	2020F
Litigation contracts - settlements			98.9	162.5	164.8
- IMF funded			98.9	82.2	60.5
- Investment vehicle (proportionate)			0.0	80.3	104.3
Litigation contracts - reimbursements			39.6	63.2	53.1
- IMF funded			39.6	32.9	24.2
- Investment vehicle (proportionate)			0.0	30.3	28.8
Litigation contracts - writedowns			4.4	7.0	5.9
- IMF funded			4.4	3.7	2.7
- Investment vehicle (proportionate)			0.0	3.4	3.2
<b>Net gain on derecognition of intangibles</b>			<b>55.0</b>	<b>92.3</b>	<b>105.9</b>
- IMF funded			55.0	45.7	33.6
- Investment vehicle (proportionate)			0.0	46.6	72.3
Litigation contract funding					
- Capitalised (incl. funding costs)			28.3	52.2	59.7
- Cash payments (incl. funding costs)			23.6	45.7	50.8

#### PROFIT AND LOSS

	2016A	2017A	2018F	2019F	2020F
Total revenue	\$m 53.0	54.1	55.0	92.3	105.9
<b>EBITDA</b>	<b>\$m 25.2</b>	<b>23.7</b>	<b>18.4</b>	<b>44.7</b>	<b>65.4</b>
Depreciation & amortisation	\$m 0.5	0.6	0.6	0.6	0.6
EBIT	\$m 24.7	23.1	17.8	44.1	64.8
Net interest	\$m (1.3)	(2.6)	(4.8)	(6.5)	(8.9)
Non-operating income	\$m 0.0	0.0	0.0	0.0	0.0
Pretax Profit	\$m 26.0	25.7	22.6	50.6	73.7
Tax expense	\$m 5.3	10.3	6.8	15.2	22.1
Minorities	\$m 0.0	0.0	0.0	0.0	0.0
<b>Operating NPAT</b>	<b>\$m 20.8</b>	<b>15.4</b>	<b>15.8</b>	<b>35.4</b>	<b>51.6</b>
Significant items	\$m 0.2	0.0	0.0	0.0	0.0
Reported NPAT	\$m 20.9	15.4	15.8	35.4	51.6

#### GROWTH PROFILE

	2016A	2017A	2018F	2019F	2020F
Operating revenue	% 263.1	2.2	1.6	68.0	14.7
EBITDA	% 173.1	(5.7)	(22.5)	143.0	46.4
EBIT	% 175.0	(6.4)	(23.1)	147.8	47.0
Operating NPAT	% 142.0	(25.6)	2.3	124.1	45.8
Normalised EPS	% (43.0)	(19.4)	138.4	(26.5)	1.7
DPS	% (25.0)	(6.7)	(21.4)	118.2	45.8

#### BALANCE SHEET

	2016A	2017A	2018F	2019F	2020F
Cash	\$m 142.5	144.9	221.8	266.8	297.0
Receivables	\$m 47.7	45.2	45.2	45.2	45.2
Inventory	\$m 0.0	0.0	0.0	0.0	0.0
Other	\$m 0.7	1.3	1.3	1.3	1.3
Current	\$m 191.0	191.4	268.2	313.2	343.5
Prop, plant & equip	\$m 1.4	1.7	1.7	1.8	1.8
Intangibles	\$m 145.6	190.9	111.5	93.5	94.3
Other	\$m 3.2	8.0	8.0	8.0	8.0
Non current	\$m 150.2	200.6	121.2	103.3	104.1
<b>Total assets</b>	<b>\$m 341.2</b>	<b>391.9</b>	<b>389.5</b>	<b>416.5</b>	<b>447.6</b>
Accounts Payable	\$m 15.3	22.1	22.1	22.1	22.1
Borrowings	\$m 79.5	119.5	119.5	119.5	119.5
Other	\$m 45.1	44.1	37.6	50.3	61.2
<b>Total liabilities</b>	<b>\$m 139.8</b>	<b>185.7</b>	<b>179.2</b>	<b>191.9</b>	<b>202.8</b>
Net assets	\$m 201.4	206.3	210.2	224.5	244.8
Equity	\$m 201.4	203.9	210.2	224.5	244.8
Minorities	\$m 0.0	2.4	0.0	0.0	0.0
<b>Shareholder's equity</b>	<b>\$m 201.4</b>	<b>206.3</b>	<b>210.2</b>	<b>224.5</b>	<b>244.8</b>

Shares on issue

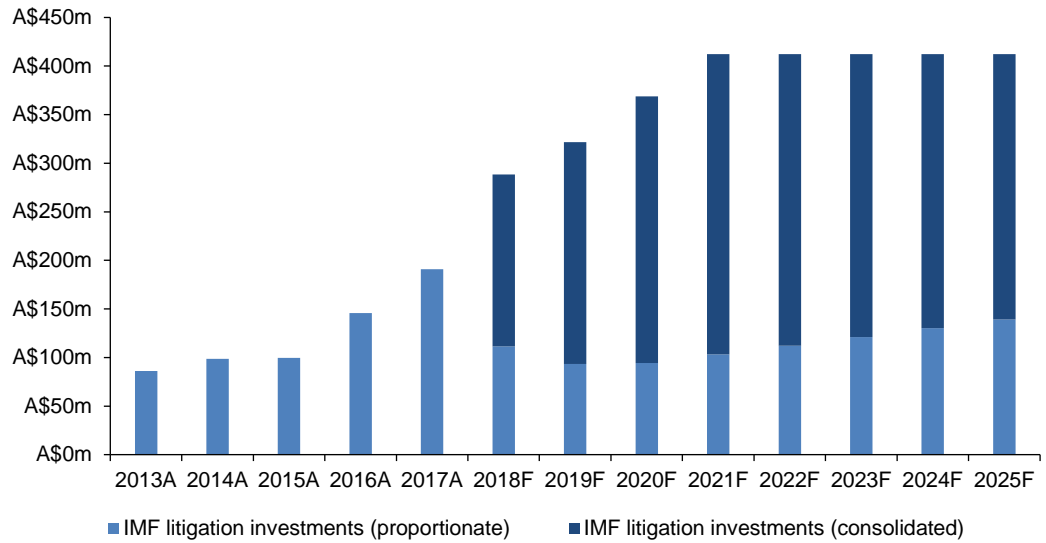
	2016A	2017A	2018F	2019F	2020F
Shares on issue	m 169.5	172.0	172.0	176.9	180.0

#### CASH FLOW

	2016A	2017A	2018F	2019F	2020F
Operating EBITDA	\$m (29.4)	(30.7)	(36.8)	(47.9)	(40.7)
Change in working capital	\$m (30.7)	9.4	0.0	0.0	0.0
Net interest	\$m (1.9)	(4.2)	(3.3)	(1.8)	0.0
Tax paid	\$m (5.3)	(11.6)	(9.8)	(8.0)	(16.2)
Other	\$m 32.3	(13.9)	0.0	0.0	0.0
<b>Operating cash flow</b>	<b>\$m (34.9)</b>	<b>(50.9)</b>	<b>(49.9)</b>	<b>(57.8)</b>	<b>(56.9)</b>
Capital expenditure	\$m (1.1)	(1.0)	(0.6)	(0.6)	(0.7)
Net proceeds from litigation funding	\$m 25.8	24.8	78.7	118.7	114.0
Acquisitions/divestment/other	\$m (4.1)	(1.6)	60.2	0.0	0.0
<b>Investing cash flow</b>	<b>\$m 20.6</b>	<b>22.2</b>	<b>138.3</b>	<b>118.0</b>	<b>113.3</b>
<b>Free cash flow (Adjusted)</b>	<b>\$m (10.2)</b>	<b>(27.1)</b>	<b>28.2</b>	<b>60.3</b>	<b>56.4</b>
Equity	\$m 0.0	0.0	0.0	0.0	0.0
Increase / (decrease) in borrowings	\$m 32.0	40.4	0.0	0.0	0.0
Dividend/other	\$m (7.5)	(7.4)	(11.5)	(15.3)	(26.1)
<b>Financing cash flow</b>	<b>\$m 24.5</b>	<b>33.0</b>	<b>(11.5)</b>	<b>(15.3)</b>	<b>(26.1)</b>
<b>Net cash flow</b>	<b>\$m 10.2</b>	<b>4.4</b>	<b>76.9</b>	<b>45.0</b>	<b>30.3</b>

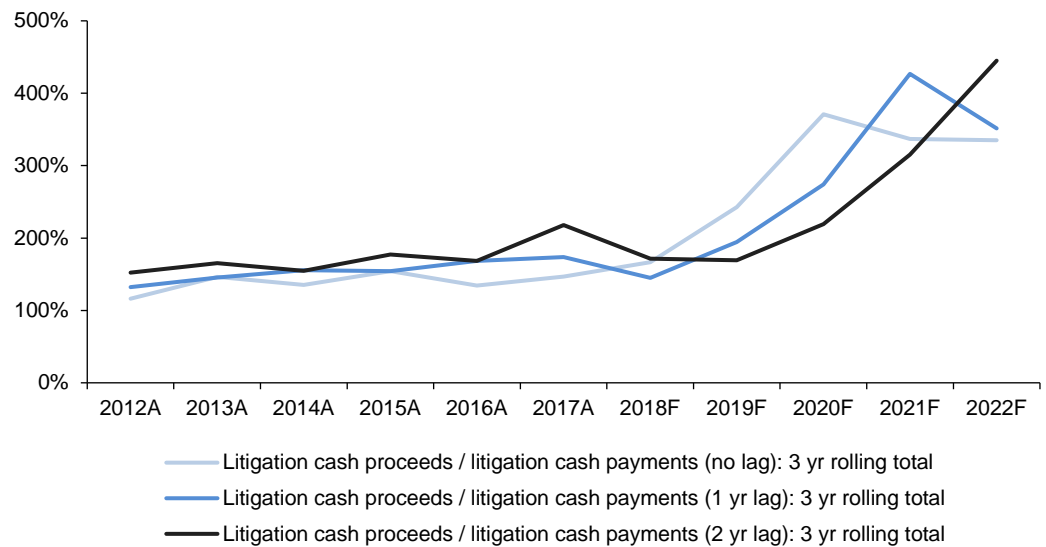
Source: Petra Capital

**Figure 1: IMF Bentham's litigation investments – Petra Capital projections**



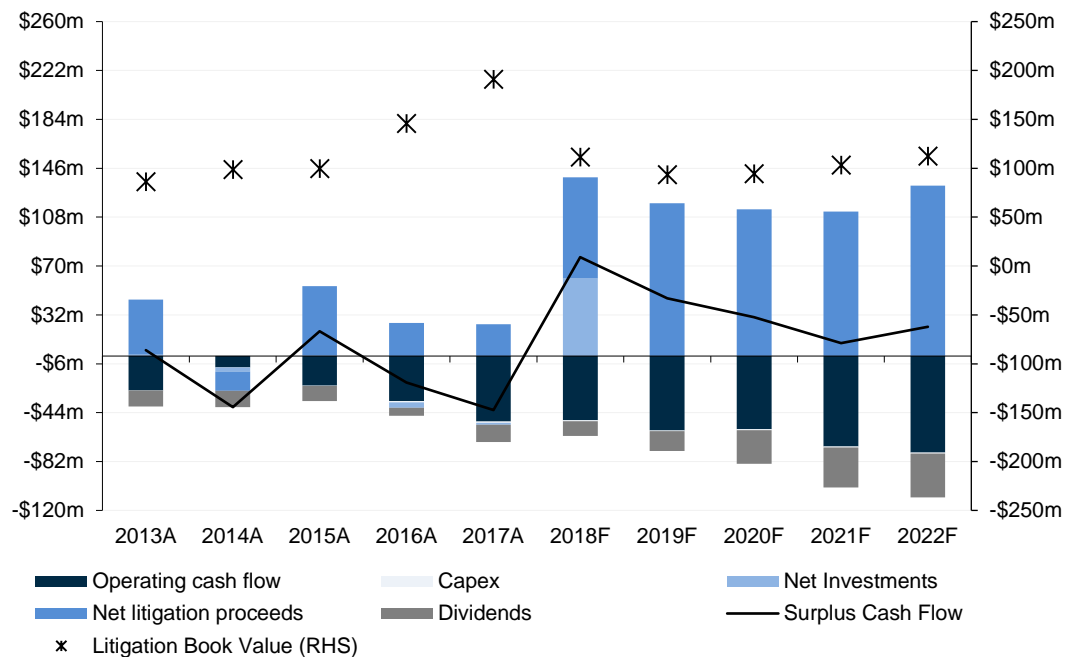
Source: Company data, Petra Capital

**Figure 2: Cash generation from litigation funding**



Source: Company data, Petra Capital

**Figure 3: IMF Bentham's cash flow**



Source: Company data, Petra Capital

**Figure 4: IMF Bentham's Discounted Cash Flow valuation**

	\$m	\$ps
<b>DCF valuation</b>		
Explicit Cashflows	204.4	\$1.12
Terminal Item	312.5	\$1.71
<b>Post Corp Tax CF Value</b>	<b>517.0</b>	<b>\$2.83</b>
Total Franking Value	102.8	\$0.56
Less: Marginal Investor Assumption	40.7	\$0.22
<b>Imputation Value</b>	<b>62.1</b>	<b>\$0.34</b>
Tax Loss Value	0.0	\$0.00
Miscellaneous Non-discounted assets	0.0	\$0.00
<b>Total Firm Value</b>	<b>579.0</b>	<b>\$3.17</b>
Less: Net Debt	(99.8)	-\$0.55
Less: Minorities	0.0	\$0.00
Less: Distributions Already Paid	0.0	\$0.00
<b>Total Equity Claims</b>	<b>(99.8)</b>	<b>-\$0.55</b>
Alternative Equity Claims	0.0	\$0.00
<b>Total Equity Value</b>	<b>678.8</b>	<b>\$3.72</b>

Source: Company data, Petra Capital

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