

ASX Announcement : 11 October 2018

LawFinance Acquisition of NHF
Interview Transcript**Diane Jones: CEO & Executive Director**
David Wattel: Founder NHF and now Director LawFinanceJustKapital Limited
Level 16
56 Pitt Street
Sydney NSW 2000**Record of interview:****Diane Jones: CEO & Executive Director**
David Wattel: Founder NHF and now Executive Director LawFinance**Introduction**

LawFinance Limited, formerly JustKapital Limited, recently announced that it has successfully completed the acquisition of National Health Finance or NHF. NHF is a US-based business that operates in a parallel business to JustKapital, which was recently renamed LawFinance. As the target company NHF was several times larger than LawFinance, being US\$53 million compared to LawFinance's market capitalisation of around A\$11 million, the deal has been complex and indeed to meet the ASX requirements has been structured as a relisting. In order to avoid more significant dilution to shareholders, the deal has been predominantly financed through a loan and this has been achieved with the support of Washington H. Soul Pattinson and several other institutional investors. LawFinance is currently undertaking an underwritten placement to institutional investors and a one-for-one non-renounceable Rights Issue to shareholders.

The CEO of LawFinance, Diane Jones, and the Founder of NHF and now Executive Director of LawFinance Dave Wattel are here to discuss the transaction, answer some of the more challenging questions about it and to explain why investors should be excited about the future for the US/Australian collaboration.

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The financing transaction recently closed saw the Company raise a \$42 million loan from investors and \$17 million from the founders. The transaction also saw 453 million warrants being issued. What is a warrant, why were they issued and isn't the share price effectively capped?

Diane Jones:

A warrant is a right to buy a share in the future at a predetermined price, in this case \$0.14. For all intents and purposes, they are really options. They were issued as an incentive to loan investors and once exercised they would raise enough money to repay the loan in full swapping the loan for new equity. It was a way to raise money at a higher price than our currently depressed stock price would allow. The warrants are long out of the money at the moment and are therefore not dilutive right now. Unless there is a takeover or LawFinance starts paying dividends, logically warrant holders would not exercise until closer to their expiry time which is in four years.

Conversion of the warrants is a positive event, [as is it is a] \$63 million Aussie capital injection which is an 89% premium to the last share price. Once exercised, the Company will have around about a billion shares on issue which at \$0.14 per share equates to a market capitalisation of \$140 million which would include \$63 million in cash.

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Given a typical private equity holding period is in the range of three to six years, why has Presidio, the PE firm that sold their stake in NHF, exited rather than continue to grow the investment?

David Wattel:

So the story with Presidio is an intriguing one and the circumstances provide a great opportunity for our shareholders. The terms of the relationship between Mark and I, NHF and Presidio were not accommodative and our access to capital was constrained. This has now been addressed and rectified with new materially larger financial facility with more flexible funding terms. It improves the return on equity on NHF cases. Combined with the current capital raising, the new facility will allow us to grow to our full potential.

Diane Jones:

If I could just add to what Dave's just said, the circumstances have provided an outstanding opportunity for LawFinance and investors should take comfort that the founders, Dave and Mark, did not take any meaningful money off the table at the time the transaction was closed. To the contrary, they've become the largest shareholders in LawFinance post this transaction and Dave has joined the Board of LawFinance.

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Why is the structure of the transaction so complicated?

Diane Jones:

That's a very good question. We are an \$11 million Aussie business buying a US\$53 million US business and raising capital to help fund the growth of both our Australian business and the US business. Without some flexibility in the deal structure, it just would not have been possible to raise the capital without diluting our existing shareholders to an uneconomic level.

In simplistic terms, we have funded the transaction by borrowing money against an asset and our servicing the cost of those borrowings from the future cash flows of the business which we are buying, the NHF business. Excluding the Rights Issue proceeds, we're raising Aussie \$24.7 million in new equity to buy Aussie \$53.8 million in net cash receivables net of all NHF debt. The vast majority of those receivables will be collected over the next two to three years. Even with all the transaction costs and interest costs, buying \$2 for \$1 is a good deal.

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Of all the choices available to US entrepreneurs, a backdoor listing into an Australian listed company, is it the most well-trodden path? What should people read into this decision?

David Wattel:

So NHF, Mark and I, we already had a US based investor and certainly could have found others. In fact, we've been approached along the way by many others. The initial discussions that we had with JustKapital and the previous management team did not envision the deal that we have now announced and completed. Mark and I, nor the management of LawFinance realised when we set on this path together that the transaction would take as long as it did. Everybody was anxious and excited to get this show on the road so to speak. But during the journey, the two companies, we formed a tremendous strong positive working relationship and we can see the benefits of working together.

For NHF, the ASX listing brings immense credibility and I've been told that already by numerous hospitals that we've had discussions with of late, and also great capital management skills. For LawFinance, NHF brings opportunity and a tremendous amount of local expertise in the US market place.

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Why if the opportunity is so large and NHF so cash generative, why does it need to do a deal at all?

David Wattel:

Well, over the 18-year history, now almost 19 years, NHF has returned about \$1.80 for every \$1 deployed. The challenge is that funds are committed for a stretch of time anywhere from under a year up to four years and beyond. Organically funding growth through recycling profits certainly is an option but it's a slow and deliberate process and the market opportunity may be taken certainly by competitors if we try to do it organically. So post-deal, NHF will be fully funded to execute on the growth opportunities currently available through our existing and ever increasing network. The market opportunity will not be there forever and with the access to capital now at hand, NHF can now become the national leader in the US medical lien market.

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Why did LawFinance not just focus on the Australian market?

Diane Jones:

Although we have a great business, the addressable market of our core JustKapital Finance division is not very large and arguably is not sustainable enough for a public company. We continue to penetrate the market and grow our legal client list but we would expect that growth

to slow as the business matures in the coming years. It will remain highly profitable but there will just be lower growth.

For LawFinance to reach its potential, we were on the lookout for opportunities in parallel markets. The acquisition of NHF fits this criteria providing exposure to an industry-leading business in a materially much, much larger market - we think at least five times could be larger - with potential growth - substantial growth in the future. The complementary nature of our business and the NHF business gives us great confidence around integration and operational improvements.

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Why is the Company exiting litigation funding?

Diane Jones:

Well, while returns can be rewarding from litigation funding, it's a very complex and capital hungry business. Cases could extend for an unknown length of time, four years and beyond, and as cases progress the funder of that case is required to write capital clause to ensure the case completes. We're also seeing a bit of yield compression in that business as competition enters the Australian market. In fact, one funder recently sought to cut their return from what was the norm of about 30% to about 10% in the recent AMP Class Action as an example. Also, I suppose regulatory risk has escalated in the last six to 12 months with multiple judges advocating for potentially capping funders fees, funders returns, as well as the new proposals which are being initiated by the Law Reform Commission.

I don't think that investors like unpredictability of revenue streams, which coupled with the risks associated with the litigation funding business, it makes allocating capital to that particular business division a suboptimal decision. Litigation funding requires scale to succeed so it was a case of getting big or getting out. We decided to get out. It has nevertheless been a very successful exercise from which we have made good returns in the cases that we've completed and we do expect to make good returns from the cases which are still running. However, the capital could be deployed in the growth opportunities that we see for the NHF business, which we believe will create greater shareholder value.

Our JustKapital Finance business is a business with far more predictability and due to the financing available can generate higher returns on our capital than Litigation Funding. The acquisition of NHS expands on this capability and opens up an extremely exciting opportunity for us in the USA. We believe investment markets will reward this growth and predictability.

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What due diligence has been conducted on NHF?

Diane Jones:

The second iteration of this transaction has taken almost a year. During that time, we've undertaken an extensive evaluation of the US receivables book and built a long-term forecast model. We've had multiple advisors, consultants and credit providers have also looked at the receivables book. The financial due diligence that's been done has been augmented by legal due diligence where we have received advice in relation to all of the operating states where NHF operates and we've even done batch reviews of hundreds of the underlying cases that form part of the NHF book.

The management team, the two management teams, have been in constant contact with each other typically speaking several times a week. Both myself and my CFO Anthony Hersch,

we've spent several weeks in Arizona working with Dave and his team over there. We visited several customers and providers of the medical services and also law firms. We've done extensive due diligence on this transaction.

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Why are there no forecasts?

Diane Jones:

We have provided our shareholders with our cash flow expectations and this is the true measure of the business. The profit and loss is difficult to predict currently due to merger accounting issues and due to the transition to AASB9 reporting obligations.

For the next couple of years, we will only be recognising a small portion of the revenue and gross profit from the business that we write. Were it not for these accounting transition issues, we would be reporting a profit for FY19 and beyond. There is a good graphical representation of how AASB9 works on page 16 of the latest Investor Presentations, which were released to the ASX on 9 October 2018.

What we will be focussing on and what metrics we will be sharing with our shareholders are these (1) growth in net receivables, (2) the cash collections and (3) the growth in the unrecognised [A1] margin - that is the profit from the business we have actually written which is not yet recognised in the profit and loss accounts due to AASB9. These three growth metrics will be highlighted and reported to shareholders as key indicators of our performance.

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How will the business be managed from Australia?

Diane Jones:

The Australian business will continue to be operated by Anthony Hersch and myself. Anthony has done an exceptional job in growing the JustKapital Financing business since his appointment in April 2016 and as has been previously communicated to the market, we expect this growth in that division to continue in the medium term, just perhaps not to such a great extent as it has done in the past two years.

NHF will continue to be managed by the Founder, Dave, who's on this call with me today and Dr Mark Siegel. Dave has joined our LawFinance Board. NHF itself has been operating for 18 years and Dave and his team have done an exceptional and scalable business that they put in place over that time. My visits to the US throughout the process have provided additional confidence in both Dave and his team and the actual opportunity that we have before us. The capital allocation decisions will be based on the growth opportunities and funding requirements within both businesses. The responsibility for those decisions will rest with me as the CEO and the Board of LawFinance.

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What are the main risks to executing on NHF's growth strategy?

Diane Jones:

In any transaction there are risks. In this transaction those risks are I suppose complicated by the geographical location of the NHF business. Some of the risks are regulatory risk, legislative changes in the US and Australia relating to the healthcare industry and the law generally. There could be delay in cash collections on the acquired receivables. There is possibly a risk of our ability to retain the NHF customers that we currently have and possibly responding to competitive challenges that we might see. New entrants could come into the market and that could have an impact on our margins. There are obviously currency and interest rate fluctuations; however, we have assessed all these risks as part of our due diligence and believe all of these risks are manageable.

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What incentives are in place for the Australian based executive team to grow earnings and shareholder returns?

Diane Jones:

Both the Australian executives and the US executives will all participate in the LawFinance Management Incentive Plan. The Management Incentive Plan will have both a short-term incentive element and a long-term incentive element. The long-term incentive element is highly likely to be in the form of scrip in LawFinance and it will be closely aligned to growth in both the domestic and the US businesses and also shareholder value creation.

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How large is the market opportunity for NHF and who are the other players?

David Wattel:

So the US personal injury market approaches US\$20 billion annually. NHF is a market-leading player in the medical lien space as we call it, with companies such as Banyan, Key Health and Canyon competing with our core product. In a vote of confidence, I'll tell you this year, George Soros backed an emerging company called Mighty Group - now this was done in June. Mighty Group is a technology platform with multiple participants in the personal injury industry, however Mighty Group did not focus on the attorney/medical provider relationships. That's an area we believe NHF has an enormous material competitive advantage based upon years in the space. Other hedge funds continue to enter the space such as the Apollo Group who has exposure through their investment in Golden Pear Funding.

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How quickly can NHF return to growth?

David Wattel:

So for some time NHF has had limited capital to deploy yet we've continued to rapidly expand our partner provider network, open up new models such as Medicare/Medicaid Replacement programs for ERs, concierge ER programs and we've grown at a 22% compounded annual growth rate for many years. Growth in the referring attorney network coupled with our expanding number of partner providers - again the other models I just mentioned - provides us an excellent leading indicator on the health of the business. With access to capital currently at our disposal, we can quickly penetrate our network and expand into new geographies as well. As a result, we expect that Company to scale quickly post closure.

If I can also add our return to growth is also based in part upon Mark and my absolute commitment to this deal and LawFinance. We are not receiving cash consideration for our equity in NHF and have both elected to take equity in our loan/warrants on similar terms to the investors. Mark and I have agreed to three-year employment contracts which we expect to extend as the business continues to grow. Holding 42.8% of the Company upon deal completion, we believe this is a huge incentive and will equate to significant growth for everybody. We're anxious and excited to explore the growth opportunities available at present.

Diane Jones:

Karen, if I could just add to what Dave's just said, we believe that the growth is the easy part of the transaction. We just want to make shareholders aware though that the move to AASB9 accounting standards will optically impact our net profit. This won't have any meaningful impact on the Company from a cash perspective but we expect the P&L to normalise over a three year period after the accounting change works its way through the NHF business. So as Dave said, I think the shareholders will quickly see that the receivables book will grow substantially in the short term.

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Will the Company require additional funding to grow?

Diane Jones:

So the funding package that we outlined as part of the transaction, allows both the Australian and the US operations to deliver strong growth over the medium term. As Dave has said in answer to your previous questions, in the US market there is a significant opportunity for further growth and further capital may be required in years to come to capture that opportunity. At that time there will be multiple options available to us to meet that challenge. Good execution will trigger the warrant conversion at \$0.14 which will inject \$63 million of equity into the business. By that point in time, we expect that our expensive debt will have been refinanced and we'll have new debt facilities being larger and at a lower cost to what we have today. So not only can that be deployed for further growth but it improves the bottom line as a result of falling interest costs.

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How do we judge the progress of NHF and when do you think we'll be able to see growth in the receivables book?

Diane Jones:

So as I've mentioned, given the impact of AASB9 on the statutory profit in the first few years of LawFinance's ownership of NHF, we will be focussing on the three key metrics being (1) the growth in the net receivables, (2) the cash collections and (3) the growth in the unrecognised A1 margin which is the profit not yet recognised in the accounts. From the outset we think these three metrics will be growing.

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