



Undervalued and poised for growth

by Roger Montgomery

Markets will typically pay a premium for a company depending on growth expectations, and then management is burdened with meeting these expectations, however rosy they may be. It's rare then to find a company, which has attractive growth prospects, which are not being valued by the market. IMF Bentham (IMF) is one such company, which has laid the foundation for long-term growth, but the market seems focused on its short-term underperformance.

IMF Bentham is a leading funder of commercial litigation in Australia, boasting an impressive track record since its formation in 2001. To the end of the 2014 Calendar Year, IMF Bentham had commenced 169 cases, of which 113 were settled, 15 were won, 6 were lost and 35 withdrawn. This model has generated \$1 billion for clients and around \$600 million to the firm, two-thirds of which has been recognised as income before administration costs.

The company had built a rigorous case selection framework and was executing this model well. But management recognised that the Australian funding market was reaching capacity and that a sustained focus on high-profile class actions would exacerbate the company's already high earnings volatility. So it began the 2015 Calendar Year with a bold vision and a renewed Board to match.

IMF Bentham wanted to significantly grow its Claims Portfolio above \$2 billion, while also improving the earnings profile of the business. It would do this by expanding aggressively overseas, particularly in North America, where it had established an office in 2011. It would also reduce the size of the claims that it funded, to reduce case duration and increase the rate of settlement.

We considered it was a reasonable and thoughtful strategy, but the burden was on the new

management team to achieve a stronger operational focus, while maintaining the integrity of the case selection process it had honed over many years.

This announcement came as the company was on track to make a record annual profit. IMF Bentham reported \$23 million of profit in the 2015 financial half year, which was well above the \$10 million generated in the full 2014 financial year. The company's market capitalisation subsequently peaked at \$411 million in February 2015.

But IMF Bentham then experienced an abnormal run of case losses. Four cases were lost in quick succession, which included the high profile Bank Fees case involving ANZ that is now being heard in the High Court of Australia. IMF Bentham settled relatively few cases in 2015, yet the cost base increased meaningfully as the company expanded overseas.

It went on to report a 2015 full year profit of \$6 million and a small loss in the 2016 half year. The market capitalisation has since fallen to \$230 million, which is modestly above its reported book value of \$180 million.

These short-term results are certainly disappointing, but the long-term potential of the company should be measured against the execution of its strategy. And management has made meaningful progress in this regard.

In December 2014, IMF had an investment portfolio of \$1.8 billion, with \$1.5 billion of value in Australia and \$300 million in the United States. One year later, IMF now has an investment portfolio of \$3.2 billion, with \$1.8 billion in Australia alone. The North America portfolio has increased to \$1.2 billion, while Asia has grown to \$111 million. Cases in the United States are also averaging \$50 million in value, compared to



Australia, where the average case value is \$92 million.

IMF Bentham has also entered Europe to pursue Standard & Poor's for its ratings of the financial instruments distributed by Lehman Brothers during the GFC. IMF Bentham's recent \$52 million settlement with S&P in Australia bodes well for its chances abroad. The firm is also funding an action in Europe against Volkswagen for its failure to inform the market about software installed in its vehicles, which distorted emissions data.

Closer to home, IMF Bentham recently achieved a \$6.6 million settlement with NAB in the Bank Fees case, which will limit the downside of an unfavourable result against ANZ in the High Court.

IMF Bentham appears very well positioned for future earnings growth, provided that management has maintained its rigorous risk assessment, while expanding the claims portfolio. When you consider that the market capitalisation of this company is close to its liquidation value, despite management doubling the claims portfolio in the past year, we feel that the investment risks are weighted more to the upside than the downside.

IMF Bentham is too small for a position in the Montgomery funds, yet it is a company we are following with interest.

IMF Bentham (IMF)



Source: Yahoo!7 Finance

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