

## **JGWPT Holdings Inc. (JGW)**

### ***Dominant Franchise in a Lucrative Niche Has 75% Upside***

We are long shares of JGWPT Holdings (NYSE:JGW), which, via its J.G. Wentworth and Peachtree brands, is the number-one player in an attractive consumer-finance market niche. JGW provides liquidity to personal-injury plaintiffs, lottery winners, and others who are entitled to long-term payment streams but have near-term financial needs. Despite its 60-70% market share, attractive organic growth rate, and ability to compound capital through acquisitions and platform expansion, JGW trades at a consensus P/E ratio of 7x, an EV/EBITDA multiple of 8x, and at nearly half of our estimate of intrinsic value.

Unlike other consumer-finance firms, JGW takes minimal credit risk and, under a well-established legal framework, obtains official court approval for every transaction it does. Regulatory uncertainty cannot justify its low valuation. But a slew of negative non-fundamental factors has dogged the stock since its November 2013 IPO: weak post-IPO trading, expiring share lock-ups, and, because of the ongoing involvement of its controlling private-equity shareholders, a small float relative to its market cap. As these non-fundamental issues fade away, the stock should re-rate dramatically on the strength of its underlying operations.

Although the sell side acknowledges the strength of JGW's business model, analysts have come up with a variety of unconvincing reasons for setting low price targets. These include unnecessarily punitive P/E multiples and unjustifiable discounts to inappropriate "peer group" valuations. Yet their targets still, on average, imply 21% upside. Notwithstanding its entrenched number-one position, JGW has compelling opportunities to further consolidate its core and adjacent markets with bolt-on acquisitions. At the time of its IPO, JGW cited six possible deals, the largest of which on its own could increase earnings by 30% and generate a more than 25% return on capital. Even without these deals, there remains great untapped potential in JGW's 120,000-strong customer database and 800,000 annual inbound phone calls. With such a discounted base-case valuation, investors are getting this growth option for free. If legacy shareholders want to sell without regard for value, we are happy to follow JGW's lead and give them "CASH NOW" in exchange for their highly attractive shares.

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## **Table of Contents**

<b><u>I. INVESTMENT HIGHLIGHTS</u></b>	<b>3</b>
<b><u>II. SITUATION OVERVIEW</u></b>	<b>5</b>
<b><u>III. BUSINESS DESCRIPTION</u></b>	<b>7</b>
<u>THE FRONT END: HOW STRUCTURED SETTLEMENTS WORK</u>	9
<u>THE BACK END: FUNDING THE BUSINESS WITH SECURITIZATION</u>	10
<u>UNIT ECONOMICS: EARNING SUPERB RETURNS ON EACH NEW TRANSACTION</u>	11
<b><u>IV. GROWTH OPPORTUNITIES: SOLID CORE EXPANSION WITH MISPRICED OVERLOOKED BOLT-ON ACQUISITION POTENTIAL</u></b>	<b>12</b>
<u>ORGANIC GROWTH: ROBUST DESPITE HEADWINDS</u>	12
<u>BOLT-ON ACQUISITIONS: JGW CAN COMPOUND CAPITAL BY ACQUIRING SMALLER PLAYERS AT 3-4X EARNINGS</u>	14
<u>SUBSTANTIAL INBOUND CALL VOLUMES COULD LEAD TO UPSELL OPPORTUNITIES</u>	15
<b><u>V. JGW'S SUSTAINABLE COMPETITIVE ADVANTAGES</u></b>	<b>16</b>
<u>UNRIVALLED BRAND PRESENCE: JGW SPENDS 10X MORE ON MARKETING THAN ITS NEAREST COMPETITOR</u>	17
<u>OPERATIONAL SCALE: JGW HAS THE BIGGEST NETWORK AND THE BEST COURTROOM TRACK RECORD</u>	19
<u>COST OF CAPITAL: CHEAP FUNDING GIVES JGW THE BEST PRICES</u>	19
<u>A WOULD-BE COMPETITOR CALLS IT QUITS: THE CASE OF IMPERIAL HOLDINGS</u>	22
<b><u>VI. VALUATION</u></b>	<b>24</b>
<u>JGW'S ENDURING TAX ADVANTAGES SUPPORT DCF UPSIDE</u>	24
<u>PRIVATE EQUITY PAID 16X EARNINGS FOR PEACHTREE IN 2005</u>	28
<u>CLARIFYING JGW'S HISTORICAL FINANCIALS</u>	29
<b><u>VII. COMPANY HISTORY: A COMPLEX CAPITAL STRUCTURE EMERGES FROM THE FINANCIAL CRISIS</u></b>	<b>32</b>
<u>JGW'S FUNDING ARRANGEMENTS REFLECT THE LESSONS LEARNED IN BANKRUPTCY</u>	34
<b><u>VIII. JGW'S BUSINESS MODEL HAS FULL JUDICIAL SUPPORT</u></b>	<b>35</b>
<b><u>IX. CONCLUSION</u></b>	<b>38</b>
<b><u>X. FULL LEGAL DISCLAIMER</u></b>	<b>40</b>

## I. Investment Highlights

- **Ubiquitous Brand Name and Entrenched Customer Base Make JGW the Undisputed Industry Leader.** JGW has 60-70% share in its core structured-settlement market; no competitor comes close to its scale. Settlement sellers typically sell only a fraction of their future payment streams in any one transaction, and then conduct follow-on sales as needed. Because JGW has the most recognizable brand and largest database of leads, it enjoys a steady flow of repeat customers, accounting for half of its transactions. These repeat customers are cheaper to acquire than new clients and add stability to revenue trends.
- **Superior Cost of Capital and Robust Cash Flows via Regular Securitization.** JGW is the only structured-settlement firm with access to cheap, consistent institutional funding via the securitization market. Having the lowest cost of funds in its sector allows JGW to offer settlement sellers the best price. In recent transactions JGW has been able to purchase assets at an 11% discount rate while Imperial Holdings, a smaller competitor, has been charging 17% - 18%. This is likely because Imperial funded its purchases through one-off transactions at high yields while JGW can reliably access 4% - 5% financing in the asset-backed securities market.

Furthermore, the gap between the value that the bond market ascribes to JGW's securitizations and the price that JGW pays to acquire assets is so large that JGW can crystallize almost all of its gain upfront. In effect, JGW's working capital is negative. The robust cash flow provided by the arrangement differentiates JGW from other securitization-funded finance companies, like mortgage originators, that often receive cash in a slow trickle over a period of many years.

- **Exciting Growth Prospects and Ability to Compound Capital Through Bolt-on Deals.** JGW has historically grown its key business drivers at mid-to-high single-digit rates, and higher interest rates in the future could lead more plaintiffs to opt for structured settlements. Moreover, as the top player in a fragmented industry, JGW has many opportunities to acquire smaller competitors and achieve synergies, yielding returns on capital of more than 25%.

Over time, JGW can do more to capitalize on its highly effective marketing, which elicits 67,000 inbound inquiries a month, only a small fraction of which it can address with its existing products. By monetizing more of these leads, JGW can boost revenue without adding meaningful expenses. And by expanding prudently in the adjacent domain of pre-settlement funding, it can begin to capture more of the litigation value chain.

- **Attractive Unit Economics.** On average, JGW buys payment streams at 34% of face value and sells them at 60% of face value, for a tremendous gross return on investment of almost 80%. Viewed from a different angle, we estimate that JGW spends \$6,700 to

acquire a new account, which in turn generates \$15,400 of pre-tax earnings net of imputed costs.

- **A Court-Sanctioned, Consumer-Friendly Business Model.** Each of JGW's structured-settlement purchases must be individually approved by a judge. This court-approval process is not just a formality: the parties often appear before the judge in person, and the judge must rule that the transfer is in the best interest of the seller and his or her dependents – or else reject it. JGW's success rate in navigating this process is 95%.

Courts endorse JGW's transactions so frequently because JGW gives its clients a fair deal. The discount rates paid by JGW are attractive compared to the costs of alternative sources of liquidity like credit cards ([19-24% for subprime borrowers](#)), payday loans (>100%), and non-bank installment loans ([18-36%](#)). Relative to these alternatives, selling a payment stream at an 11% discount rate to repay higher-cost credit-card debt is a sensible financial move.

- **Conservative DCF Valuation Implies 75% Upside to Current Share Price.** JGW was expected to IPO at \$19 to \$22 a share, but the deal went badly and priced at \$14. Since then, shares have struggled to gain traction, in part because JGW is the only major public company in its niche. But we estimate that its intrinsic value is almost \$30, incorporating the benefit of the long-term tax deferral generated by JGW's business model but not factoring in the upside from its growth initiatives. The performance of other recent consumer-finance IPOs also suggests a fair value in the mid-\$20-to-\$30 per share range. If the sector once again sparks M&A interest, we note that in 2005 Peachtree, then JGW's largest competitor, sold to private equity for almost 16x pretax income. That multiple would imply a price for JGW of \$36, 115% higher than where it trades today.

## II. Situation Overview

Below is a snapshot of JGW's financial and valuation metrics ([JGW S-1](#), 10-Q3 [2013](#)).

### Capitalization & Multiples

*Fiscal Year End Dec 31st*

<b>Share Price (US\$)</b>	<b>\$16.95</b>
Diluted Shares <sup>(1)</sup>	29.6
<b>Market Capitalization</b>	<b>\$501.4</b>
Corporate Debt <sup>(2)</sup>	449.5
Cash <sup>(2)</sup>	(44.8)
<b>Enterprise Value</b>	<b>\$906.2</b>

Trading Multiples	\$	Multiple
EV / LTM EBITDA <sup>(3)</sup>	\$113.1	8.0x
EV / '14E EBITDA <sup>(3)</sup>	113.7	8.0x
LTM P/E <sup>(4)</sup>	\$2.00	8.5x
2014E P/E <sup>(4)</sup>	2.32	7.3x

### Financial Statistics

	2011	2012	LTM
Gain on Sale	\$145.6	\$219.2	\$229.3
% of Core TRB <sup>(5)</sup>	19.0%	23.9%	23.6%
% Growth	n.a.	50.5%	4.6%
Other	42.9	58.6	51.0
% Growth	n.a.	36.8%	(13.0%)
<b>Total Revenue<sup>(3)</sup></b>	<b>\$188.5</b>	<b>\$277.8</b>	<b>\$280.3</b>
% Growth	n.a.	47.4%	0.9%

Source: JGW filings, Capital IQ, Kerrisdale analysis

(1) Includes Class B and Class C shares, which are convertible into the public Class A shares.

(2) Pro forma for the IPO and subsequent debt paydown.

(3) EBITDA and revenue as shown are adjusted figures calculated by Kerrisdale.

(4) Based on "adjusted net income" as defined by the company. 2014 P/E based on consensus.

(5) Core TRB consists of guaranteed structured settlements, annuities, and lottery payments.

Since JGW only became public in November, the historical financial information available is limited. Furthermore, because it grew dramatically in mid-2011 by acquiring its largest competitor, Peachtree, year-to-year comparisons are distorted. Still, at first glance, the stock looks very cheap, trading at 7x consensus EPS. This simple conclusion survives a much more detailed analysis. Below we present an overview of our DCF valuation, which gives JGW credit for the ongoing tax benefits associated with the mismatch between its cash flows and the IRS treatment thereof, as explained in greater detail below. We conservatively assume only 5% growth in acquisition volume and minimal operating leverage.

### Kerrisdale Discounted Cash Flow Analysis

	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Free Cash Flow Build-Up (\$mm)</b>									
Net Revenue	\$251.2	\$269.5	\$283.8	\$298.8	\$314.6	\$331.3	\$348.8	\$367.3	\$386.7
% Growth	-4%	7%	5%	5%	5%	5%	5%	5%	5%
<b>Adjusted EBITDA</b>	<b>102.7</b>	<b>113.7</b>	<b>120.2</b>	<b>127.0</b>	<b>133.7</b>	<b>140.8</b>	<b>148.2</b>	<b>156.0</b>	<b>164.2</b>
Adjusted EBITDA Margin	40.9%	42.2%	42.3%	42.5%	42.5%	42.5%	42.5%	42.5%	42.5%
D&A / Provision / Stock-Based Comp.		(15.2)	(15.9)	(16.7)	(17.6)	(18.5)	(19.5)	(20.5)	(21.6)
Non-Cash Residual Interest Income		(10.2)	(10.9)	(11.6)	(12.3)	(12.9)	(13.6)	(14.3)	(15.1)
Non-Cash Component of Gain on Sale		(20.6)	(22.0)	(23.5)	(24.7)	(26.0)	(27.4)	(28.8)	(30.3)
Cash Pre-Tax Income	\$67.7	\$71.3	\$75.2	\$79.1	\$83.3	\$87.7	\$92.3	\$97.2	\$97.2
Cash Income-Tax Expense	-	-	-	-	-	-	18.4	19.4	20.4
Cash Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	21.0%	21.0%	21.0%
<b>Free Cash Flow</b>	<b>\$67.7</b>	<b>\$71.3</b>	<b>\$75.2</b>	<b>\$79.1</b>	<b>\$83.3</b>	<b>\$87.7</b>	<b>\$92.3</b>	<b>\$97.2</b>	<b>\$97.2</b>
Discounted Value of FCF		62.6	61.2	59.7	58.2	56.7	43.7	42.6	41.5
Discount Rate									8.0%
Terminal Growth Rate									3.0%
Implied Terminal FCF Multiple									20.0x
Terminal Value									\$1,581.5
Implied Exit Multiple of Trailing EBITDA									9.6x
Discounted Value of Interim CFs	\$426.0								
Discounted Value of Terminal Value	854.4								
<b>Intrinsic Enterprise Value</b>	<b>\$1,280.5</b>								
Less: Net Debt / (Cash)	404.7								
Intrinsic Equity Value	\$875.7								
Implied 2014E EV/EBITDA	11.3x								
Implied 2014E P/E	12.8x								
Shares Outstanding	29.6								
<b>Implied Fair Value per Share</b>	<b>\$29.60</b>								

Source: Kerrisdale analysis, JGW filings.

Note: forward multiples are based on 2014 adjusted EBITDA and adjusted net income.

It's easy to see why JGW's investment bankers thought that an initial price of \$19 to \$22 was reasonable. It would still leave room for meaningful upside, especially when considering the possibility of accretive M&A, which isn't included in our DCF. JGW has said publicly that it's evaluating six acquisition candidates, the largest of which could cost only \$75 million yet generate \$20 million of incremental adjusted net income – a 27% immediate return on capital.

JGW also trades cheaply relative to other recent consumer-finance IPOs, which fetch P/E multiples 27-93% higher despite much greater exposure to regulatory and credit risk. Even sell-side analysts, who openly admit to undervaluing the stocks, assign price targets from \$19 to \$22 (the same as the original IPO range), offering 12-30% upside:

**Sell-Side Price Targets for JGW**

Firm	Price Target	Upside	Date
Barclays	\$21.00	24%	Dec-13
Credit Suisse	\$19.00	12%	Dec-13
Deutsche Bank	\$21.00	24%	Dec-13
Jefferies	\$19.00	12%	Dec-13
JMP	\$22.00	30%	Feb-14
KBW	\$20.00	18%	Dec-13
Stephens	\$21.00	24%	Feb-14
<b>Average</b>	<b>\$20.43</b>	<b>21%</b>	

Sources: Bloomberg, equity research

Looking back to pre-crisis M&A in the structured-settlement industry, JGW's upside appears even larger. When the private-equity firm DLJ bought JGW's former competitor Peachtree in 2005 (before JGW later acquired Peachtree itself), the price paid was nearly 16x run-rate pre-tax income. At that valuation, JGW would trade at \$36, 115% higher than the current price.

We believe that JGW's discounted valuation is a function of its messy history, including a pre-packaged bankruptcy in 2009, and its unusual status today as a public company still 62% owned and 93% controlled (based on voting rights) by its previous private equity owners. This overhang makes investors (and analysts) fearful of stepping in front of imminent lock-up expirations and potential share sales.

It doesn't help that JGW is both obscure and unique, sharing certain qualities with some specialty finance companies but lacking the natural audience commanded by banks and insurance companies. In the short term, JGW's upcoming fourth-quarter earnings announcement is unlikely to excite since IPO-related non-recurring items will dominate the results. But none of this fundamentally alters the value of JGW's business, which is far greater than the market is implying today. In return for bearing the short-term risk of bad technicals, investors with a longer term horizon can buy a premier consumer franchise on the cheap.

### III. Business Description

*It's fascinating how many people don't really know anything about structured settlements when it's such a lucrative industry.*

—former sales manager at a JGW competitor (February 2014)

For many TV viewers and radio listeners, J.G. Wentworth needs no introduction; the slogan "It's my money, and I need it now!" and the phone number 877-CASH-NOW are ingrained in the public consciousness, given that the company's ads generate over 130 million impressions per week. JGW's primary business, accounting for 88% of its revenue, is acquiring structured-



settlement payment streams from individuals and reselling them at a higher price to institutional bond investors. The model is similar for state-sponsored lottery payouts, which generate 7% of JGW's revenue, and conventional annuities, which generate 2%. The balance of the company's sales comes from pre-settlement funding.

JGW has recently been buying settlements at an average discount rate of 10.92% and securitizing them at an average discount rate of 4.37%. The company issues approximately three securitizations per year. For a hypothetical structured settlement of \$100,000 paid out in equal installments over 25 years, for an average life of 12.5 years, the present value at a 10.92% discount rate is ~\$34,000, while at a 4.37% discount rate it's ~\$60,000. **JGW is thus able to re-sell its wares at more than a 70% mark-up, only a few months after buying them.** The size of the gain will vary based on a variety of factors, including the duration of the payment stream – the same discount-rate gap will produce smaller profits for shorter-lived streams – and the jurisdiction in which JGW conducts the transaction, given that legal frameworks vary across different states. Offsetting these gains are costs associated with marketing, underwriting, etc. But even after these costs, JGW generates strong profit margins: over the last twelve months of reported financials, JGW's adjusted EBITDA margin, as we define it below, was 44%.

Below are summaries of two recent transactions conducted by JGW that highlight the variety of possible sales structures. In the first case, New York resident Patrick Paccione transferred a single large lump sum; in the second, Desmond Benn of South Carolina transferred more than 20 years of small monthly payments, starting in 2032. In both cases, we estimate that JGW likely realized a healthy gain on sale. The customer benefits as well. Folks turn to JGW because the discount rates it charges are very attractive compared to the costs of alternative sources of liquidity like credit cards (19-24% for subprime borrowers), payday loans (>100%), and non-bank installment loans (18-36%).



### JGW's Structured-Settlement Purchases: Two Case Studies

Transferor	Patrick Paccione	Desmond Benn
State	New York	South Carolina
Contract Date	10/4/13	3/12/13
Total Payments Purchased	\$45,000	\$52,200
Weighted Average Life (Years)	30.0	5.0
Price Paid (A)	\$22,100	\$3,000
Discount Rate on Purchase	15.2%	10.7%
Illustrative Securitization Discount Rate <sup>(1)</sup>	4.5%	4.5%
PV at Securitization Discount Rate (B)	\$36,054	\$14,479
Implied Gross Gain (A - B)	\$13,954	\$11,479
As a % of Purchased Payments	31%	22%
As a % of Price Paid	63%	383%

Payment Schedule		Payment Schedule	
10/16/18	\$45,000	5/2/32	\$200
		6/2/32	\$200
		7/2/32	\$200
		...	
		11/2/53	\$200
		12/2/53	\$200
		1/2/54	\$200

Source: [NY Supreme Court \(Suffolk County\)](#), [SC Court Of Common Pleas \(Charleston County\)](#)

(1) Actual rate for each individual case is unknown, but recent securitization deals have priced at 4.0% - 4.5%.

### The Front End: How Structured Settlements Work

Structured settlements are simply an alternative to the lump-sum payments typically used to resolve personal-injury litigation. Rather than receive the proceeds upfront, a claimant may negotiate to receive a larger amount split into, say, equal monthly installments disbursed over 25 years; more complicated schedules can also be devised to fund specific needs like near-term medical bills or college tuition.

One reason to opt for a structured settlement is to mitigate the risk of “dissipation” – i.e. to keep plaintiffs from spending down their windfalls too quickly. Congress encouraged structured settlements in 1982 by affirming that structured-settlement payments, unlike their lump-sum cousins, are exempt from federal income tax. A claimant who uses a lump-sum settlement to buy an annuity will pay tax on the embedded interest, but a claimant who accepts a structured settlement with exactly the same payout schedule as the annuity will pay no tax. As intended, this financial asymmetry fostered greater acceptance of structured settlements, which have totaled \$350 billion since 1975, of which \$140 billion still remains to be paid out.

Claimants don't directly rely on the parties with whom they're settling to fund their payments in future years. Instead, defendants (or their insurers) purchase annuities from major life insurance companies, some of whom have specialized units focusing on structured settlements. Therefore

claimants receive their checks from the likes of MetLife and Allstate, not the entities they originally sued. Not only do these firms generally boast high credit ratings but because the annuities rank *pari passu* with other customer claims, they are actually senior to the firms' rated debt and would thereby, in the unlikely event of an insurer default, have the right to draw on the reserve funds established by state regulators to protect insurance policyholders.

Structured-settlement payment streams thus constitute valuable financial assets with minimal credit risk. But because even large personal-injury settlements don't approach institutional trading size, they're highly illiquid assets. As time passes and financial needs change, the owners of these assets sometimes find that selling all or a portion of their long-term payment streams is the best option they have to reduce credit-card balances, make a down payment on a house, or pay college tuition. But non-specialized consumer lenders and big banks lack experience with structured settlements' legal and operational complexities.

That's where JGW comes in. As the leading buyer of structured settlements, JGW has the scale and know-how to offer liquidity to claimants at a reasonable price with terms better than what they could achieve via alternative sources of financing. Because deals are sourced one by one in small increments, marketing scale and brand recognition are critical to building a profitable operation in this sector; consumers gravitate toward companies they know. Through two decades of effective advertising, JGW has achieved a market share of 60-70%, making it the closest thing to a household name in the sector. As the head of sales at one of JGW's largest competitors told us, "Guys in the industry, whenever we're explaining what we do, we have to say, 'Have you ever heard of J.G. Wentworth?'" (February 2014).

### ***The Back End: Funding the Business with Securitization***

*Structured settlement ABS is a sub-class of the non-mortgage ABS space that offers stable and predictable cash flow returns with little credit risk and very low correlation with consumer asset classes. ... The extremely low default experience in this collateral over the past 10 years stands as a testament to the minimal risk inherent in this space.*

—Barclays securitization research, *Introduction to Structured Settlement ABS* (April 2012)

Settlement sellers are often motivated by personal financial difficulties, but because the underlying value of their payment streams depends on the credit quality of the annuity provider, not the beneficiary, there's no need to turn away applicants with weak FICO scores or low incomes. In a sense, JGW does for individuals what a factoring firm like CIT does for small businesses – supply liquidity to those who hold money-good receivables but lack ready cash. Whereas CIT might buy the right to collect from Wal-Mart a payment that it owes to a manufacturer of socks, JGW could buy the right to collect from Berkshire Hathaway a payment that it owes to the victim of a car accident.

To make these purchases, JGW has constructed a well-funded, diversified source of working capital. Through September 30, 2013, JGW was on pace to spend \$420 million acquiring settlement streams, up 8% from 2012. Because of the high quality of the assets it buys, along with its strong operational track record, JGW can obtain very advantageous near-term “warehouse” funding from investment banks before ultimately pooling, tranching, and selling the payment streams into the asset-backed securities market.

As an intermediary between investors and individuals, JGW can only sustain this business model by offering a good value proposition to both sides of the market – and it does. Institutional fixed-income investors have no interest in purchasing individual structured settlements. For one thing, individual settlements are much too small: there’s no Bloomberg ticker or CUSIP for, say, the 20-year stream of \$338.86 monthly payments owed by Prudential to [Janay Phipps](#) as part of the settlement of a lawsuit regarding lead-paint exposure. But a diversified portfolio of a few thousand such receivables, assembled by a reputable market leader, can give rise to a relatively attractive investment even at a low absolute yield of 4-5%. Given the lack of credit or prepayment risk, JGW’s asset-backed securities are well-suited for the likes of the [MetWest Total Return Bond Fund](#), [BlackRock Total Return Fund](#), and [Nuveen Core Bond Fund](#) (the issuing entity sometimes appears under names like 321 Henderson Receivables, LLC). New deals are routine: JGW just closed a new securitization, [series 2014-1](#), in [early February 2014](#). Regular access to cost-effective securitization is, in turn, what allows JGW to supply its customers with the liquidity they need at a competitive price. Smaller players with less attractive funding sources are hard-pressed to match JGW’s value proposition. For example, Imperial Holdings, a second-tier competitor, has never accessed the securitization market and instead funds itself by reselling settlements intermittently at 10-11% yields. Imperial passes these high funding costs on to its customers, charging them 17-19% on average, much worse than what JGW offers. Despite these high rates, Imperial still doesn’t generate a profit in this business because it can’t attract enough customers to cover its fixed costs. This illustrates the importance of securitization as a competitive edge for JGW.

### ***Unit Economics: Earning Superb Returns on Each New Transaction***

To further explore how JGW’s business model works, we attempt to reconstruct the profitability of a single new transaction at the margin. Based on the average of the last three securitizations for which there is public data, the aggregate payments sold in an average deal total about \$94,000. This figure implies that JGW originates roughly 850 transactions per month, consistent with other sources’ ballpark estimates of 750 to 1,000. Assuming that general and administrative expenses are fixed but compensation and professional/consulting costs are fully variable – a conservative premise – we calculate from JGW’s LTM results that the average transaction generates ~\$15,400 in profit from a marketing investment of ~\$6,700, for a **130% net return**:

### ***The Marginal Profitability of Incremental Advertising Dollars***

#### *Illustrative Analysis*

	\$
Face Value of Payments Purchased	\$94,147
Gain on Sale to Securitizable TRB	<u>23.6%</u>
Implied Gain on Sale	\$22,249
<i>Operating Expenses:</i>	
Compensation and Benefits	(\$4,212)
Professional and Consulting	(1,832)
Debt Issuance Costs	<u>(849)</u>
Total Variable Expenses	<u>(\$6,892)</u>
Implied Return on Investment	\$15,357
Advertising Spending	\$6,670
Return on Advertising Spending	130%

Source: JGW [IPO prospectus](#), JGW 10-Q3 2013, JGW [presentation \(January 2014\)](#), Kerrisdale analysis

These figures are merely illustrative, and profitability will vary from deal to deal, but the message is clear: the reason that JGW advertises so heavily is that it pays to do so. Effective marketing brings in new customers, and new customers are quite valuable.

## **IV. Growth Opportunities: Solid Core Expansion with Overlooked Bolt-On Acquisition Potential**

### ***Organic Growth: Robust Despite Headwinds***

Because JGW went public only recently, there is no consistent, long-term time series of its primary operational metrics. Moreover, the esoteric nature of JGW's business results in little available industry data. Both issues have made the sell-side reluctant to project meaningful growth.

Examining the data itself, though, points to respectable organic expansion. Below we summarize JGW's disclosures regarding its "total receivables balance" (TRB), the undiscounted face value of its asset purchases, since 1H 2012. The numbers imply solid organic growth of 5-10%.

### Payment Streams Purchased by JGW

	H1 2012 <sup>(1)</sup>	3Q2012	4Q2012	H1 2013 <sup>(1)</sup>	3Q2013
TRB	\$254.2	\$282.8	\$278.7	\$282.6	\$299.3
% Growth	n.a.	n.a.	n.a.	11.2%	5.8%

Source: JGW IPO prospectus and 3Q13 earnings release

(1) Average quarterly level (only six-month data disclosed).

Another key measure, the size of JGW's database of customer leads, is difficult to observe at a high resolution, but by stitching together disparate disclosures it's possible to estimate a longer-term growth rate. Peachtree [noted](#) in its 2005 IPO documents that its customer database contained 25,000 entries, while JGW's bankruptcy-court filings from 2009 (source: [PACER](#)) indicate a JGW database of 56,500 candidates, at which point Peachtree was approximately 60% of JGW's size. Today, JGW says its database covers 122,000 existing and prospective customers. Tying the figures together, the organic growth rate in the JGW/Peachtree database over the past eight years has been roughly 8%:

### Estimated Growth of JGW's Customer Database

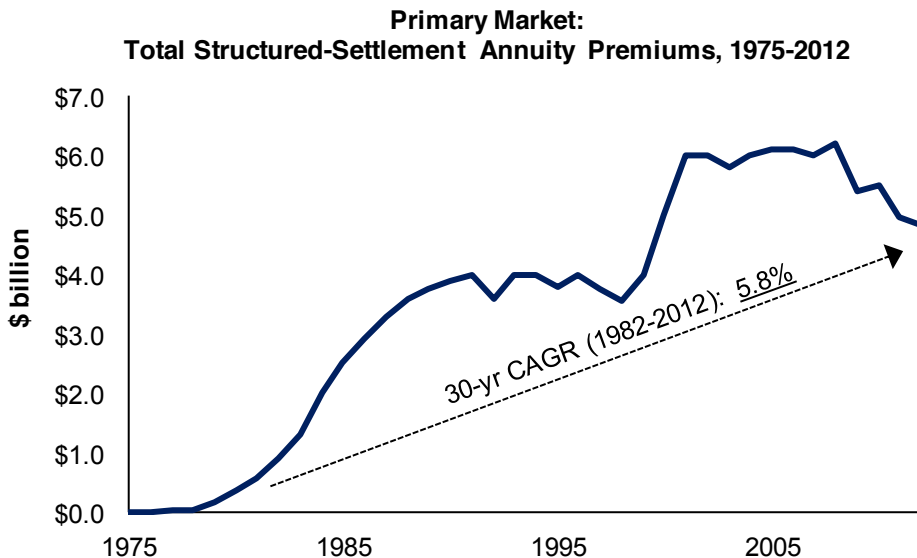
	2005	2009	2013
Peachtree Database	25,000	33,900	
Assumed % of JGW <sup>(1)</sup>		60%	
CAGR, 2005-09		7.9%	
JGW:			
Existing Clients		15,700	
Prospective Clients		40,800	
Total JGW Database		56,500	
Combined JGW/Peachtree		90,400	122,000
Implied Database CAGR, 2009-13			7.8%

Source: JGW S-1/A, JGW 2009 bankruptcy petition, Kerrisdale analysis

(1) Per JGW's IPO prospectus, Peachtree was 63% as large as standalone JGW in 2011 (combined assets of \$3.8B, Peachtree assets of \$1.5B, implied standalone JGW assets of \$2.3B). We multiply the size of standalone JGW's 2009 database by 63% to estimate the size of Peachtree's 2009 database.

According to JGW itself (in its IPO prospectus), its database CAGR since August 2008 (including only guaranteed structured-settlement payment customers) has been roughly in line at 6%. Whatever the exact number, it appears that the core business has been expanding at a mid-to-high single-digit pace.

This estimate aligns with the available data on the size of the primary market – that is, the flow of new structured settlements, which may or may not be sold to the likes of JGW at a later date. After a long period of rapid growth, the primary market plateaued in the early 2000s, peaked in 2008 at \$6.2 billion, and has declined gradually since then.



Source: National Underwriter Life and Health Magazine, compiled by [SK2M Limited](#)

However, it's important to remember that the primary market is really a gauge of the first derivative of the outstanding stock of structured settlements; thus even a declining primary market could represent merely *slowing growth*, not necessarily shrinkage, in the total stock. The exact net growth rate will depend on how quickly old settlements pay out.

We believe that a key factor in recent primary-market weakness is the fall in interest rates. Claimants may be more inclined to take lump sums over deferred payouts when rates are low, since the difference in the cumulative proceeds from the two different options will be smaller than normal. Higher interest rates, therefore, may provide a boost to the primary market and reignite organic growth.

Regardless, JGW has proven that it can grow in any interest rate environment. Besides, the overall market opportunity remains largely untapped, so JGW can continue to deepen its penetration into the large existing base of structured-settlement claimants. Of the approximately \$140 billion in outstanding structured settlements, about \$130 billion, or 93%, is still available for purchase in the event that claimants face new or unexpected financial needs. At the current P/E multiple of less than 7x, JGW's stock is pricing in incredibly low growth expectations. Should JGW begin to report sustained single-digit volume growth, potentially translating into double-digit earnings growth, the stock could re-rate substantially.

### ***Bolt-On Acquisitions: JGW Can Compound Capital by Acquiring Smaller Players at 3-4x Earnings***

Aside from increased organic penetration of its core market, one promising growth opportunity for JGW is the acquisition of smaller competitors in what is, despite JGW's dominance, still a fragmented market. There are dozens of independent firms engaged in structured-settlement



purchasing and adjacent activities. JGW is so dominant that some competitors merely scavenge leads that it generates. But others run their own marketing and create real value – value that JGW could likely optimize by leveraging its robust existing infrastructure. In its IPO prospectus, JGW laid out a near-term agenda for pursuing these sorts of bolt-on acquisitions:

*We are currently in discussions with six companies that are potential acquisition targets participating in certain of our existing markets. While no definitive terms have been discussed, we may go forward with at least one such potential acquisition in the near term. We estimate that the purchase price for any such potential acquisition would be in the range of \$5 million to \$75 million, which may be payable in cash, stock or a combination thereof. The various market participants under consideration have annual revenues ranging between \$5 million and \$40 million. If we consummated an acquisition of any one of these six market participants, we estimate that our annual Adjusted Net Income would increase by between \$5 million and \$20 million.*

If JGW's initial estimates are accurate, then it is currently exploring deals that generate \$20 million of adjusted net income at a cost of just \$75 million, or about 4x earnings. At this price, JGW can redeploy its free cash flow at returns in excess of 25%. **Such a \$75 million deal would boost adjusted EPS by almost 30% immediately.** A transaction of this magnitude is not contemplated in current consensus estimates.

### ***Substantial Inbound Call Volumes Could Lead to Upsell Opportunities***

JGW's intensive marketing strategy elicits many leads, but few convert: only 1.5% of inbound calls ultimately generate revenue. To be sure, any call-center operation will face some level of dropped and misdirected calls, but many of the inquiries are real – they are just related to products that JGW doesn't currently offer. Before acquiring Peachtree, JGW acted as broker and referred leads for products like lotteries or annuities to other firms in exchange for a fee; with these capabilities now in-house, there is less scope for referral fees in those areas, but other logical possibilities like secured credit cards, reverse mortgages, and installment loans remain untapped.

JGW's largest expansion opportunity is pre-settlement funding, which it already offers, but only in small size (3% of revenue). Rather than acquiring payment streams from finalized settlements at a discount, JGW effectively makes a small equity investment in a pending settlement. This enables plaintiffs and their lawyers to ride out short-term liquidity problems rather than accept higher-cost short-term financing offers while under duress. In keeping with the underlying equity-like risk – the clients owe nothing if they lose their case – JGW can earn interest and fees on its funds that exceed statutory usury caps, while still benefiting from its own access to leverage via a \$35-million facility with Capital One. Unlike JGW's core business, pre-settlement funding currently entails some principal risk. But as long as JGW can properly price these deals, and who else but JGW could, the risk-adjusted returns should be as attractive as those in its core business.



Since the regulatory framework for pre-settlement funding is far less established than that for structured-settlement factoring, JGW has taken a measured approach to the business, honing in on just 26 states with particularly favorable judicial environments. But the total market size is enormous: tort settlements in the US amount to \$122 billion a year, vastly more than structured settlements alone. Capitalizing on this opportunity and making fuller use of JGW's existing legal expertise and relationships will take years, especially since it could require new state-level legislation, but JGW investors today are paying nothing for this valuable option on a large adjacent market. While the existing pre-settlement funding business is too small a contributor to JGW's results to have its own historical segment data, JGW's recent S-1 gives guidance on overall profitability: *"our pre-settlement fundings are typically high-quality short duration assets featuring an average life of less than two years and are priced to generate an ultimate return on a pool basis of 1.5x – 2.0x funded amount."* Using this information, we estimate the incremental earnings power of the business below. **If JGW can increase originations by \$35 million – equal to the size of its current financing facility but still representing less than 3 basis points of the total market opportunity – we estimate a 17-26% lift in EPS.**

#### ***Illustrative Pre-Settlement-Funding Opportunity***

Targeted Gross Return	150%	200%
Targeted Net Return	50%	100%
Average Term (Years)	1.5	2.0
Illustrative Annual Volume (\$mm)	\$35.0	\$35.0
Incremental Earnings per Year	\$11.7	\$17.5
JGW Shares Outstanding	29.6	29.6
<b>Incremental Adjusted EPS</b>	<b>\$0.39</b>	<b>\$0.59</b>
2014 Consensus EPS	\$2.32	\$2.32
<b>% Increase in EPS</b>	<b>17.0%</b>	<b>25.5%</b>

Source: JGW S-1/A, Kerrisdale analysis

## **V. JGW's Sustainable Competitive Advantages**

*I don't see there being another J.G. Wentworth. ...There's just such a wide gap between J.G. Wentworth and every other player.*

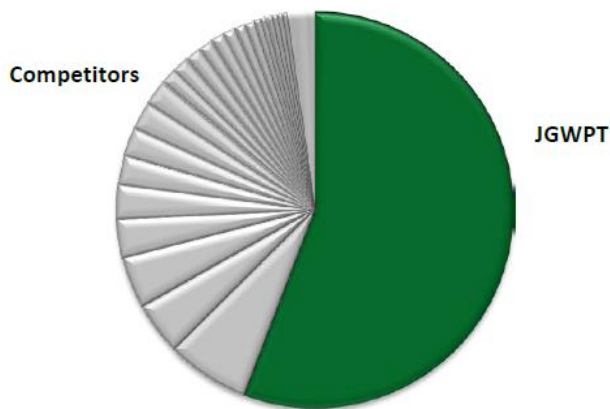
—former sales manager at a JGW competitor (February 2014)

JGW is clearly the top buyer of structured settlements, but it doesn't have a monopoly; as shown in the chart below, there are dozens of smaller players. Furthermore, if the estimates we sketch out above are accurate, then the economic returns JGW achieves are very attractive. Yet no competitor since Peachtree has been able to seriously challenge JGW's operational,

financial, and brand dominance. It has led the industry for more than 20 years. The sources of its strength are simple but powerful.

#### *JGW's Estimated Market Share*

### Market Landscape



Source: Represents that portion of all cases filed that were visible to management via Westlaw throughout the country. Percentages in the graph reflect total activity between January – September 2013.

Source: JGW presentation, January 2014

#### ***Unrivalled Brand Presence: JGW Spends 10x More on Marketing than its Nearest Competitor***

Since 1995, JGW has invested \$615 million into its marketing efforts; in 2012 alone, it spent \$73 million (source: JGW S-1/A, February 2014). In recent years, the disparity on this front between JGW and its smaller competitors has grown to gargantuan size. Since 2008, J.G. Wentworth and Peachtree have spent approximately ten times as much on television ads as their next largest competitor, accounting on their own for 80% of the entire industry's total. Not only does JGW manage to consistently reach prospective clients – the company estimates that over 80% of its target audience sees a J.G. Wentworth or Peachtree ad at least five times a week – it has also made the most of its broad reach by crafting a unique brand image with its quirky, memorable campaigns. Search for “J.G. Wentworth” on YouTube and you’ll find almost 10,000 results, ranging from [parodies](#) (“J.G. Crackworth: it’s your crack, and you need it now”) to [paeans](#) (“Babies love this commercial and dogs go crazy too”). Of course, not everyone is a fan, but the ads have been undeniably effective at building enviable brand recognition for what is a rather niche business. Google Trends attests to the magnitude of the company’s lead in consumer awareness over two of its largest competitors:

## Google Trends: JGW's Brand Presence Towers Over Its Peers



Source: [Google](#)

Drumming up organic leads is especially important in this industry because actually finding people with structured settlements to sell is no easy task. Since settlements are established in individual local jurisdictions, there is no centralized data source one can use to find prospects; thus, without large-scale brand recognition, it's hard to pull in enough volume to pay the bills.

Marketing success is also at least partially self-fulfilling, because settlement beneficiaries often don't sell their entire payment streams in their first transactions. Instead, they may cash out on a portion and then, perhaps a few years down the road, do so again when another financial need arises. Because JGW has acquired more settlements than anyone else, it's more likely to get the call when past customers seek funding again; as a result, roughly half of its new volume comes from previous clients, and the average client conducts about two transactions with the company over time. By systematically tracking leads, JGW has gradually accumulated a database of 122,000 structured-settlement holders, representing \$32 billion of potential future acquisitions (source: JGW S-1/A, February 2014) – a very sizable pool relative to current deal flow of approximately \$1 billion a year. By generating so many repeat customers, JGW's branding not only lends more stability to the business but also boosts profitability, since repeat customers are naturally cheaper to acquire.

### **Operational Scale: JGW Has the Biggest Network and the Best Courtroom Track Record**

*You have to be very diligent with underwriting these transfers, making sure that there's no federal liens or anything like that, just making sure that all the disclosures are executed properly, that the settlement annuity information and all the documentation is in order, basically confirm that they're entitled to the payments, nothing's being encumbered, there's no child support being taken out. You have to notice the annuity issuer and obligor. You have to make sure that there's independent professional advice...The customer may or may not have to appear in front of a judge. If they do appear in front of a judge, they have to be prepared. If they don't, they may have to have a lawyer sign off to say that they understand the paperwork...Make sure there are no pending bankruptcies... **It's a big deal underwriting all these things.***

—former sales manager at a JGW competitor (February 2014)

Though buying and re-selling structured settlements is conceptually simple, actually completing transactions requires substantial expertise. Rules and processes vary from state to state, and a single procedural misstep could suffice to make an unfriendly judge reject a proposed transfer (and thereby waste all the marketing and underwriting costs it took to get to that point). In a company of only 346 people, JGW employs 27 dedicated, in-house legal professionals to oversee all aspects of the business and presides over a nationwide network of external attorneys covering each of the more than 3,000 counties in the country. It's no accident, then, that JGW leads the industry with a 95% court-approval success rate (source: JGW presentation, January 2014).

Customers aren't interested in long, drawn-out formalities. To succeed, settlement purchasers like JGW have to be easy to do business with, while still taking pains to handle all the technicalities correctly. Having completed 61,000 purchases since 2002, JGW has the experience to manage its relationships well, maintaining a smooth transition from initial client screening to final funding in a matter of 30 to 60 days. JGW even offers [iPhone](#) and [Android](#) apps that facilitate document scanning and uploading for customers without easy access to fax machines.

After making the purchase, JGW must then be able to collect on future payments owed by the life insurance companies serving as annuity providers, and insurers are not known for making complex transactions pleasant. It helps that JGW already has well-developed relationships with more than 200 insurance companies. Such operational advantages set a high bar for would-be competitors.

### **Cost of Capital: Cheap Funding Gives JGW the Best Prices**

*I think you have to have – and Wentworth has shown this – obviously you have to have a successful advertising campaign...but then once you get the leads in, what do you do with them? If you don't have the lowest cost of funds, and you're consistently losing to*

*J.G. ... that's not a sustainable model. That's basically being free advertising for everyone else.*

—head of sales at a JGW competitor (February 2014)

*...J.G. Wentworth is the type of company that just says, "Hey, we have the best price in the industry." They're a securitization model; they're not a broker model like the majority of the other competitors. They have such a great cost of funds that they're able to offer the best price.*

—former sales manager at a JGW competitor (February 2014)

After acquiring Peachtree, JGW is currently the only structured-settlement buyer with demonstrated access to the securitization market, having issued 38 deals totaling more than \$5 billion since 1995. The most recent deal – HENDR 2014-1 – was issued on February 18, 2014. While the economics of acquiring low-risk assets at double-digit yields are attractive even on a hold-to-maturity basis, securitization enables JGW to accelerate future cash flow and recycle its capital into additional purchases. For example, even after retaining a 6.5% interest in the underlying receivables and paying off the revolving line of credit that had previously financed them, JGW netted \$32.3 million of cash from its 2013-3 issuance of \$212.7 million in bond principal – cash it could then re-invest into additional purchases. Because the company can routinely generate much more cash from financing its assets than it needs to consume to create them, it effectively runs with negative working capital, while smaller players are stuck with far less favorable financing terms.

The key reason for JGW's low cost of capital is simple: the stunningly good credit performance of its past issuances. While the logic behind the structured-settlement asset class always seemed reasonable – a diversified portfolio of highly rated life-insurance exposures should hold up well even in a troubled economy – it wasn't until the financial crisis that this thesis was truly put to the test. Through it all, over a period of more than a decade, JGW's collateral has experienced *cumulative* credit losses of only 0.08% – not 0.08% per year, but 0.08% in total over the entire time span (source: JGW presentation, January 2014). Furthermore, since JGW retains the most subordinated piece of the capital structure (typically 6.50-6.75% percent of first-loss capital), those eight basis points never touched bond investors, who, unlike so many of their ABS-buying peers, emerged from the Great Recession totally unscathed. With this strong track record in hand, JGW should be able to access financing even in the most adverse environment; at the height of the crisis, when most securitization markets collapsed, the longest interval between JGW's securitizations was still only 10 months.

## JGW's Latest Securitization: Basic Background Data from Bloomberg

DES

Bloomberg

ABS

66  
<60>

SECURITY DESCRIPTION

HENDR 2014-1A A

Page 1 of 3

CUSIP: 46617TAA2 Issuer: 321 HENDERSON RECEIVABLES LLC

Series 2014-1A Class A Exp Mty 7/15/42

5) ABS:

CURRENT	ORIGINAL ISSUE
Feb14 212,167,000	USD 212,167,000
" Fact 1.000000000	WAL 10.6Yr @ OCPR
Coupon 3.96%	1st coupon 3.96%
Next Paymt 3/15/14	1st paymnt 3/15/14
Rcd date 3/ 4/14	1st settle 2/18/14
Beg accrue 2/18/14	Dated date 2/18/14
End accrue 3/14/14	px 99-30 2/10/14
Class/Deal Pct N/A	Class/Deal Pct 91%

3.96%

3/15/63

PRVT PLACEMENT

1) RATINGS

MDY (P)Aaa

DBRS AAae

CALLABLE

6) Lead Mgr:Joint

Trustee: UBN

Monthly PAYMENT

pays 15th day

0 day delay

accrues 30/360

65) Personal Notes

14) Identifiers

NO COLLATERAL AVAILABLE

TRACE Eligible

SMMEA: No

144A Eligible

DTC Book Entry

DTC SameDay

See Page 3 for Comments.

MinSize 50000 Incr 1000

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000

Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2014 Bloomberg Finance L.P.

SN 175493 EST GMT-5:00 H702-1901-3 12-Feb-2014 19:06:58

Source: Bloomberg

While JGW clearly has a long head start over its competitors in the realm of funding, bond investors care more about the underlying assets than the identity of their originator, so others may eventually be able to securitize their receivables on terms similar to JGW's. Thus the cost-of-capital advantage might diminish over time. Here, though, JGW's sheer size again gives it a leg up. Since the bond market dislikes illiquid, odd-lot securities, ABS issuers need to stockpile enough assets to achieve critical mass and pique the interest of large investors. With its heavy inbound call volume, JGW has the consistency and throughput to bring deals to market every few months, but for competitors that are less than one-tenth of its size, it could take years to accumulate the two to three thousand receivables that JGW typically pools into a single securitization. A second credible securitizer may emerge one day, but not overnight; for now, JGW's access to the capital markets is, for its sector, unique.

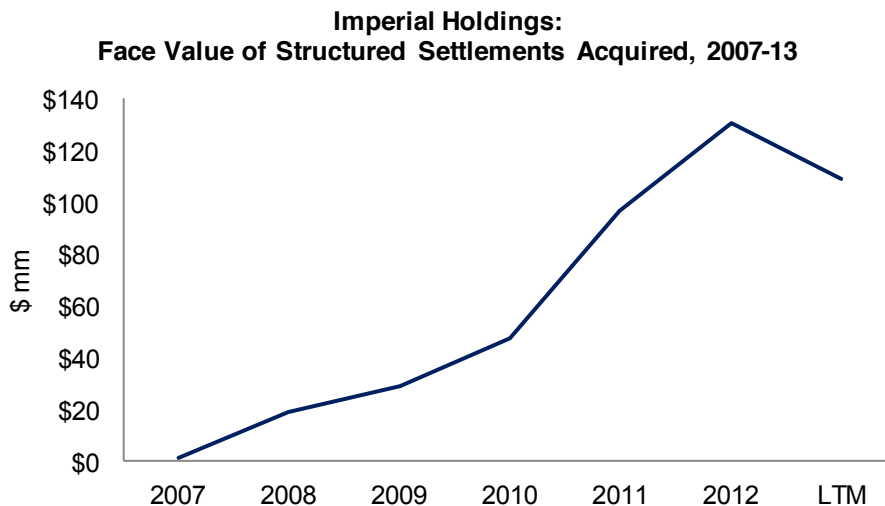


## ***A Would-Be Competitor Calls It Quits: The Case of Imperial Holdings***

*[Imperial] dumped a lot of money into television, and they dumped a lot of money into advertising, that just – I don't know. It was crazy looking at some of those filings. They were just bleeding money left and right.*

—head of sales at a JGW competitor (February 2014)

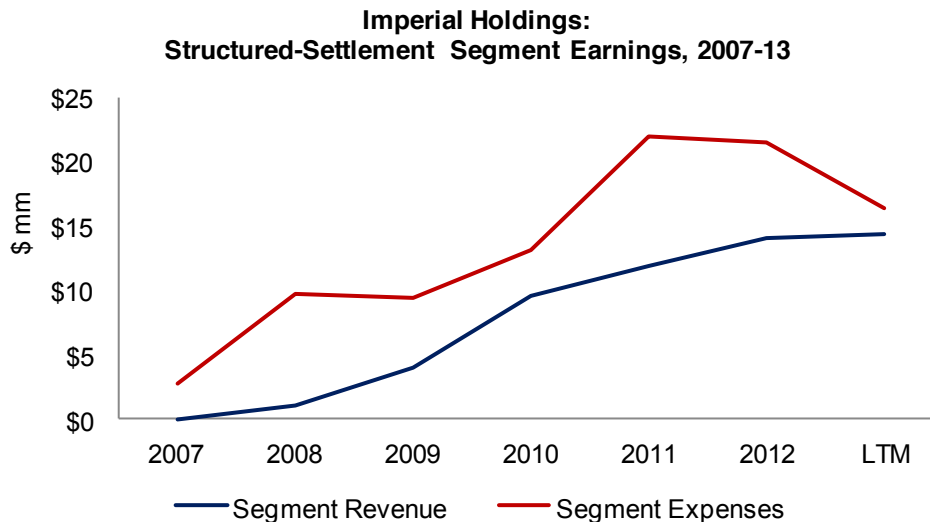
One interesting window into the difficulty of breaking into the structured-settlement market comes from the experiences of Imperial Holdings, Inc. (IFT). Imperial is a Florida-based specialty-finance company that now focuses exclusively on its core business of life settlements. But recently, Imperial attempted to build up its own structured-settlement operations. Founded in December 2006, Imperial started small, purchasing just 10 structured settlements in 2007, but it boasted a very promising management team, including seasoned leaders from Singer Asset Finance, an early innovator in the field, and Peach Holdings, which has since become part of JGW. Over the next five years, Imperial rapidly ramped up its acquisition volume:



Source: Imperial filings ([IPO prospectus](#), [2010 10-K](#), [2011 10-K](#), [2012 10-K](#), and [3Q13 10-Q](#))

Notwithstanding the distraction caused by an unrelated federal investigation of the life business in 2011, Imperial grew from a standing start to a top-ten player in structured-settlement purchasing. Imperial pursued many of the same strategic priorities as JGW, such as compiling a thorough database of prospects and retaining customers for repeat transactions. Still, this growth came at a high price: from 2007 through the first nine months of 2013, Imperial's expenses in the structured-settlement unit totaled \$95 million. Despite this large investment, the segment never broke even:





Source: Imperial filings (2010 10-K, 2011 10-K, 2012 10-K, and 10-Q)

Even with a sizable budget and experienced management, Imperial could not manage to attract enough business to cover its fixed costs. The lack of scale also prevented Imperial from achieving low-cost funding via securitization, which in turn made it likely that JGW could give prospective customers better prices. This ensured that Imperial only completed transactions with less informed customers who were willing to part with their payment streams at discount rates in the high teens.

**Imperial: Discount Rates for Structured-Settlement Segment**

	2008	2009	2010	2011	2012	9M2013
Weighted Average Discount Rates:						
At Purchase	12.0%	16.3%	19.4%	18.2%	18.7%	17.2%
At Sale	10.8%	11.5%	8.9%	10.5%	10.6%	9.5%

Source: Imperial filings (2010 10-K, 2011 10-K, 2012 10-K, and 10-Q)

Ultimately, Imperial chose in October 2013 to give up on this initiative and sell the platform to Blackstone for \$12 million, for an approximate cumulative pretax net loss of \$28 million – an expensive lesson in the dangers of fighting for share in a consolidated market. Blackstone presumably has a plan for making Imperial’s operations more profitable, and JGW will likely face new competition in the future. But the failure of the previous iteration of this threat to create a sustainable business model proves that overcoming JGW’s manifold advantages is no easy task.

## VI. Valuation

*I'm assuming at some point a bigger firm would want to acquire them...They have pretty amazing cash flows.*

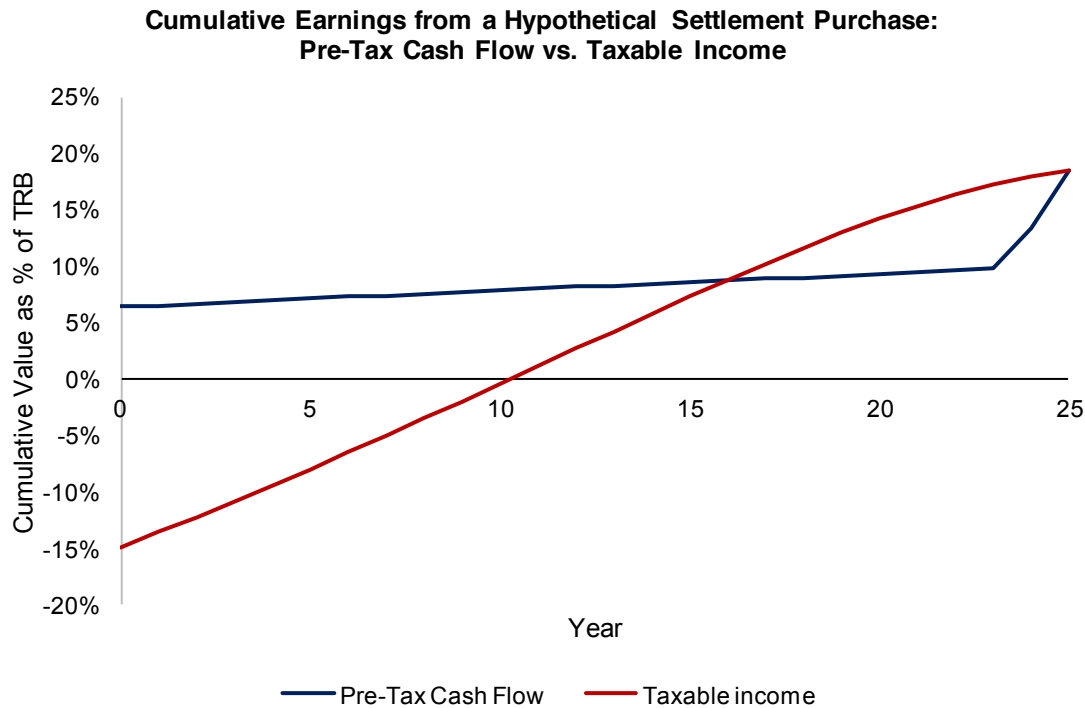
—former sales manager at a JGW competitor (February 2014)

Seeing the strength of JGW's business through the lens of its reported financial results is, unfortunately, challenging. This has given investors pause, prevented the sell-side from focusing on detailed DCFs, and contributed to JGW's current discounted valuation. For one thing, there is no unbroken time series of past quarterly earnings because of the firm's history of private ownership coupled with scanty IPO disclosures. The lack of pure-play public competitors adds further difficulty to analyzing the business's long-term financial track record. What financials are disclosed are muddled by misleading GAAP accounting that forces the consolidation of JGW's securitization trusts even though the underlying assets have already been sold to third parties. Complicating matters further, JGW benefits from certain ongoing tax advantages that are not obvious on cursory inspection. Sorting through these issues, we estimate that a conservative DCF would value JGW at approximately \$30, or 75% above the current stock price.

### ***JGW's Enduring Tax Advantages Support DCF Upside***

JGW's historical results include almost no income-tax expense, but only because the firm was previously organized as an LLC, passing its income through to its owners for tax purposes. In future quarters, JGW will, in fact, accrue a normal GAAP income-tax expense. Yet sell-side analysts and the company itself prefer to focus on "adjusted net income," a pre-tax measure. **There's a good reason for this emphasis: for years to come, JGW will pay minimal cash taxes.** In the eyes of the IRS, its securitizations constitute financings, not sales; thus the company records revenue for tax purposes on a gradual, phased-in basis as receivables pay down, even though economically it receives the bulk of its cumulative cash flow very early on when it completes a securitization. This tax deferral is compounded by the upfront timing of many of JGW's expenses, like advertising, which should generate net operating losses that can be carried forward into the future. Eventually, the company will start to pay increasing amounts of cash taxes, but the interim benefit is valuable.

To better illustrate the way that JGW's model works, consider the following hypothetical case: JGW acquires \$100,000 of future payments, spread evenly over the following 25 years (consistent with a 12.5-year weighted average life), at a 10.9% discount rate and securitizes them on the basis of a 4.4% discount rate (both consistent with recent experience). Using the rough assumption that core operating expenses scale with payment volume, we estimate that this transaction will generate ~\$18,400 in net pre-tax cash flow as well as taxable income (see Appendix for further details). However, the cash arrives early while the taxable income trickles in more slowly (and doesn't cross into positive territory for years):



*Source: Kerrisdale analysis. See Appendix for complete details.*

*Note: the cash-flow increase in Years 24 and 25 stems from cash collected on JGW's residual interest in the securitization once the senior bonds are paid off, as well as the release of the cash reserve account.*

On a present-value basis, using an 8% discount rate, the pre-tax cash flow is worth 8.6% of the total receivables balance (TRB), while, net of taxes, it's worth only 6.7%-6.9%, equating to a 20-21% economic tax rate, substantially lower than a statutory tax rate of 35-38%.

How exactly this benefit flows into JGW's results over time will depend on the rate at which JGW's operating expenses rise relative to TRB. For the purposes of our DCF, we assume that the company pays no cash taxes for the first five years and afterwards incurs economic taxes at a rate of 21%, consistent with the output of the analysis above. Assuming what is effectively business as usual – 5% growth in TRB, little operating leverage, and flat gain-on-sale margins – we arrive at a fair value per share of almost \$30:

### Kerrisdale Discounted Cash Flow Analysis

	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Free Cash Flow Build-Up (\$mm)</b>									
Net Revenue	\$251.2	\$269.5	\$283.8	\$298.8	\$314.6	\$331.3	\$348.8	\$367.3	\$386.7
% Growth	-4%	7%	5%	5%	5%	5%	5%	5%	5%
<b>Adjusted EBITDA</b>	<b>102.7</b>	<b>113.7</b>	<b>120.2</b>	<b>127.0</b>	<b>133.7</b>	<b>140.8</b>	<b>148.2</b>	<b>156.0</b>	<b>164.2</b>
Adjusted EBITDA Margin	40.9%	42.2%	42.3%	42.5%	42.5%	42.5%	42.5%	42.5%	42.5%
D&A / Provision / Stock-Based Comp.		(15.2)	(15.9)	(16.7)	(17.6)	(18.5)	(19.5)	(20.5)	(21.6)
Non-Cash Residual Interest Income		(10.2)	(10.9)	(11.6)	(12.3)	(12.9)	(13.6)	(14.3)	(15.1)
Non-Cash Component of Gain on Sale		(20.6)	(22.0)	(23.5)	(24.7)	(26.0)	(27.4)	(28.8)	(30.3)
Cash Pre-Tax Income	\$67.7	\$71.3	\$75.2	\$79.1	\$83.3	\$87.7	\$92.3	\$97.2	\$97.2
Cash Income-Tax Expense	-	-	-	-	-	-	18.4	19.4	20.4
Cash Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	21.0%	21.0%	21.0%
<b>Free Cash Flow</b>	<b>\$67.7</b>	<b>\$71.3</b>	<b>\$75.2</b>	<b>\$79.1</b>	<b>\$83.3</b>	<b>\$83.3</b>	<b>\$69.3</b>	<b>\$72.9</b>	<b>\$76.8</b>
Discounted Value of FCF		62.6	61.2	59.7	58.2	56.7	43.7	42.6	41.5
Discount Rate									8.0%
Terminal Growth Rate									3.0%
Implied Terminal FCF Multiple									20.0x
Terminal Value									\$1,581.5
Implied Exit Multiple of Trailing EBITDA									9.6x
Discounted Value of Interim CFs	\$426.0								
Discounted Value of Terminal Value	854.4								
<b>Intrinsic Enterprise Value</b>	<b>\$1,280.5</b>								
Less: Net Debt / (Cash)	404.7								
Intrinsic Equity Value	\$875.7								
Implied 2014E EV/EBITDA	11.3x								
Implied 2014E P/E	12.8x								
Shares Outstanding	29.6								
<b>Implied Fair Value per Share</b>	<b>\$29.60</b>								

Source: Kerrisdale analysis

Note: forward multiples are based on 2014 adjusted EBITDA and adjusted net income.

How does JGW look on the basis of more conventional metrics, like simple P/E ratios? While the question of taxes muddies any simple comparison, the answer is that it looks quite cheap, trading at 7.3x 2014 consensus EPS and 6.4x 2015 consensus EPS. Though there are no especially similar public firms (given JGW's high share in its core market), it's instructive to compare the performance of JGW's stock to that of two other recent specialty-finance IPOs: Springleaf (LEAF) and Santander Consumer USA (SC). Like JGW, both firms provide liquidity to cash-strapped consumers, but unlike JGW they do so by assuming major exposure to credit risk and competing directly against large, entrenched lenders. Despite the superior nature of JGW's specialty finance niche, the company trades at a material discount to these comparables, and, unlike them, has declined in price relative to the range originally contemplated by the IPO underwriters. **At LEAF or SC's multiples of ~12x 2014 P/E, JGW would trade at about \$28, not below \$17.** Moreover, we believe that JGW's business model is superior to LEAF's or SC's given its higher market share, freedom from credit risk, and well-known consumer brand.

### Relative Valuations of Recent Consumer-Finance IPOs

Company	Price	Market cap (\$mm)	Consensus EPS		Price / Earnings	
			2014	2015	2014	2015
Springleaf Holdings	\$26.14	\$2,821	\$1.85	\$2.30	14.1x	11.4x
Santander Consumer	\$25.35	8,834	\$2.55	\$3.12	9.9x	8.1x
JGWPT Holdings	\$16.95	\$501	\$2.32	\$2.66	<b>7.3x</b>	<b>6.4x</b>
Peer Multiples:			Low		36%	27%
			High		93%	78%
JGW Price Implied:			Low		\$23.07	\$21.58
			High		\$32.72	\$30.19

Company	First Trading Day	Initial IPO Price Range		Return versus IPO Range	
		Low	High	Low	High
Springleaf Holdings	10/16/13	\$15.00	\$17.00	53.8%	74.3%
Santander Consumer	1/23/14	\$22.00	\$24.00	5.6%	15.2%
JGWPT Holdings	11/8/13	\$19.00	\$22.00	(23.0%)	(10.8%)

Source: Capital IQ, Kerrisdale analysis

While sell-side estimates for JGW are relatively reasonable, and the stock has received numerous “buy” ratings, it’s interesting to observe how frequently analysts confess that they’ve *artificially pushed down their own price targets* in view of a host of cosmetic factors:

- Deutsche Bank: “[S]ince the company has no publicly traded peers, we find it difficult to compare its valuation. Instead, we use a comp universe that includes direct-to-consumer businesses (both financial and other), financial consumer brokers, insurance brokers, asset recovery managers, payday lenders and mortgage servicers in our comp universe. Compared to all companies in the comp universe, JGW shares trade at a 54% and 49% discount to median price-to-earnings and PEG valuations, respectively” (Deutsche Bank report, Dec. 4, 2013). Instead of using these median levels to value JGW, though, DB decides to use the *bottom quartile* instead, thus keeping its price target closer to the trading price.
- JMP: “Our \$22 target price equates to a modest 8.5x our 2015 EPS estimate of \$2.65, roughly a 10% discount to the average forward (2014) earnings multiple for public consumer specialty finance and debt collector stocks that we view as peers” (JMP report, Dec. 13, 2013). Again, why the arbitrary discount – and in what sense are “debt collector stocks” really “peers”?
- KBW: “While there are no pure public comparisons for the company, we believe an 8x price-to-earnings multiple is appropriate (if not conservative) for JGW when taking into account its earnings growth opportunity (both organic and inorganic), size and scale,

strong market-leading brands, limited exposure to credit risk, and strong cash flow generation” (KBW report, Dec. 4, 2013). With all these strengths, why apply such a conservative multiple?

- Jefferies: “Our price target of \$19 is based on 8x our FY14 ANI estimate of \$2.43, a substantial discount to the 13x P:E of the comp group” (Jefferies report, Dec. 3, 2013). Substantial indeed: a 38% discount with an unconvincing rationale.
- Credit Suisse: “Our target price of \$19 is set using a multiple of 8.4 times on our 2014 adjusted net income estimate. We would note that the companies that serve the needs of nonprime consumers but do not take material credit risk or regulatory risk (such as Western Union and MoneyGram) sell at multiples of 11-15 2014 EBPS on consensus and CS estimates” (Credit Suisse report, Dec. 3, 2013). In other words, economically similar firms garner valuations that are 30-80% higher, yet the target multiple remains the same.
- Barclays: “While we believe the company is intrinsically worth ~12x forward earnings based on our DCF valuation, we set our price target at \$21 based on 8x our 2015 estimate of adjusted net income, which reflects a discount for the accounting complexity of the company’s business” (Barclays report, Dec. 4, 2013). Going from 8x to 12x equates to 50% upside, yet Barclays would write that off as a reasonable discount for accounting complexity.

It’s hard to avoid the conclusion that sell-side analysts actually believe that JGW should trade at a substantially higher valuation than it does, but – reluctant to set price targets too much at odds with current market prices – come up with excuses to bring down their numbers. In the long run, though, investors who are willing to accept a bit of “accounting complexity” in exchange for a market-leading consumer franchise should profit.

### ***Private Equity Paid 16x Earnings for Peachtree in 2005***

When a private-equity firm bought Peachtree’s former owner Peach Holdings in 2005, it was a few months after Peach Holdings had gone public. This revealed enough publicly available financial data to compute valuation metrics (which is not the case with JGW’s own buyout). While there are reasons to discount the relevance of this analogy – for instance, 27% of Peach’s [2005 revenue](#) came from life settlements, a business JGW does not conduct – the fact remains that Peach Holdings sold for almost 16x run-rate pre-tax earnings, which would imply a price for JGW of more than \$36, 115% above the current price.

### ***Precedent Transaction: Peach Holdings Buyout***

<i>(\$mm)</i>	2005	H1 2006 annualized
Reported Pre-Tax Income	\$37.1	\$8.6
Deferred Revenue Recognized on Securitization	—	40.0
Adjusted Pre-Tax Income	\$37.1	\$48.6
Price Paid by DLJ Merchant Banking Partners	\$763.0	\$763.0
Price to Adjusted Pre-Tax Income	20.6x	15.7x
JGW 2014 Consensus EPS	\$2.32	\$2.32
<b>Implied JGW Price</b>	<b>\$47.77</b>	<b>\$36.41</b>
Upside to Current Price	181.8%	114.8%

Source: [Peach Holdings documents](#), [DLJ press release](#), Kerrisdale analysis

Since JGW is larger, more entrenched, and less replicable today than Peachtree was in 2005, we would argue that, if anything, a higher multiple makes sense.

### ***Clarifying JGW's Historical Financials***

Below we present JGW's reported earnings, rearranged to highlight the core elements and set aside the noise. Note that because JGW acquired Peachtree halfway through 2011 and never provided public pro-forma financials combining the two operations, comparisons with 2011 would look misleadingly strong.



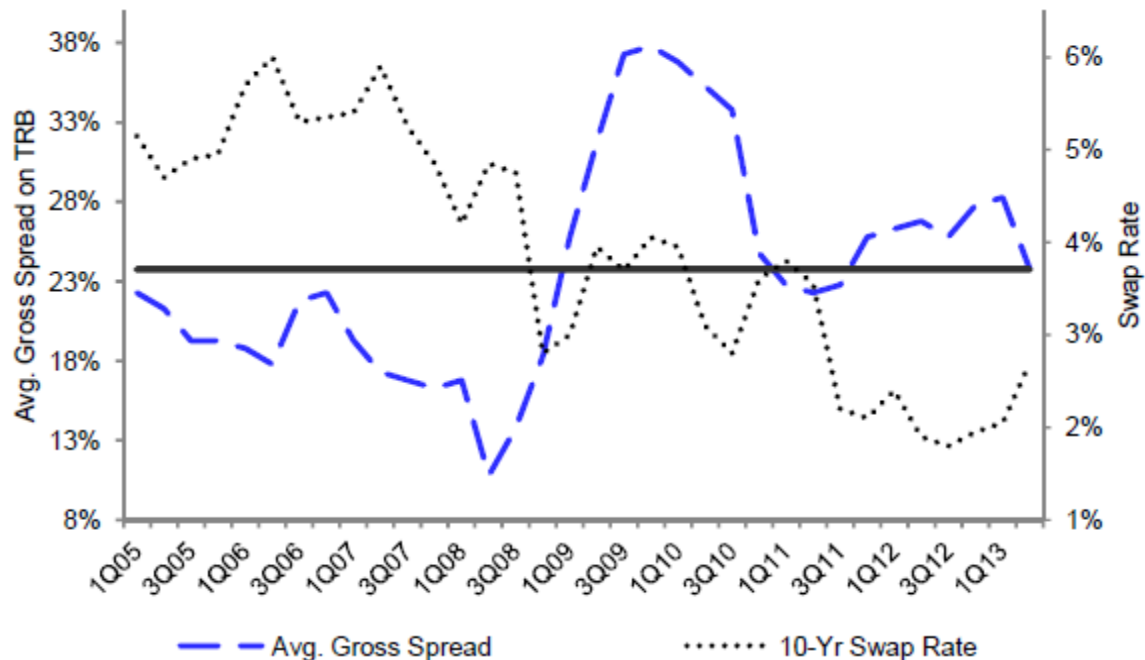
### ***JGW's Historical Earnings Power***

	FY Ended 12/31/12	LTM Ended 9/30/13
<b>Adjusted Earnings (\$mm)</b>		
Gain on Sale	\$219.2	\$229.3
<i>% of Core TRB</i>	<i>23.9%</i>	<i>23.6%</i>
Interest Income	44.2	41.6
Servicing, Broker, and Other Fees	14.4	9.5
Total Revenue	\$277.8	\$280.3
Warehouse Interest Expense	17.5	20.7
Net Revenue	\$260.3	\$259.7
Advertising	73.3	68.7
Other Cash Opex	76.3	77.8
Total Cash Opex	149.6	146.5
Adjusted EBITDA	\$110.7	\$113.1
<i>% of Net Revenue</i>	<i>42.5%</i>	<i>43.6%</i>
<i>% of Total TRB</i>	<i>10.4%</i>	<i>9.9%</i>
Non-Cash Recurring Expenses	(12.6)	(14.2)
Net Impact of Securitization Accounting	(4.4)	(7.0)
Fair-Value Items, Net	44.7	59.1
Non-Recurring Expenses	(4.7)	(9.9)
EBIT	\$133.8	\$141.1
Term-Loan Interest	14.5	33.9
Pre-Tax Income (As Reported)	\$119.2	\$107.2
Income Taxes	(0.2)	1.4
Net Income	\$119.5	\$108.6

Source: JGW filings (IPO prospectus, [3Q13 earnings release](#), 3Q13 10-Q), Kerrisdale analysis

JGW's key revenue driver is the gain on sale that it books upon purchasing a receivable and, for the most part, crystallizes soon after via securitization. This gain, measured as a percentage of the total receivables balance (TRB) acquired, has historically averaged in the mid-20% range and has recently been running at this same level. The chart below demonstrates that JGW can maintain its profit spread through any interest-rate environment.

Figure 11: Spread (per \$100k TRB) Compared to 10-Yr Swap Rate



Source: Company Reports and Deutsche Bank

Source: Deutsche Bank report, December 4, 2013

After paying for advertising and other cash operating expenses, JGW is left with an adjusted EBITDA margin of 44%. What separates this figure from reported GAAP earnings?

- *Non-cash recurring expenses:* depreciation, stock-based compensation, and the provision for loan losses (driven by the small pre-settlement-funding business as the core structured-settlement business does not face material credit risk) generate non-cash charges in every period. Since these are all economically meaningful, we incorporate them into our DCF analysis.
- *Net impact of securitization accounting:* under GAAP, because JGW exercises control over its economically off-balance-sheet securitization trusts by virtue of servicing them, it must incorporate their assets and liabilities into its results, obscuring the real results. The company does, however, disclose enough supplemental information to undo this accounting distortion.
- *Fair-value items:* another unpleasant consequence of GAAP is that JGW marks to market both sides of its securitization trusts' balance sheet, typically resulting in an unrealized fair-value gain when interest rates decline and a loss when they rise. While rates do impact the value of JGW's small portfolio of retained interests from past securitizations, the value of future business volume is what primarily drives the company's total worth, and because it can adjust upfront pricing as its cost of funds changes, adverse rate moves should have only a transitory effect.

- *Non-recurring expenses:* severance and M&A-related costs are real but not particularly relevant to future results.
- *Term-loan interest:* as further explained below, JGW's formerly private owners chose to fund a large dividend to themselves by leveraging up the company with a term loan before taking it public, then using a portion of the proceeds to pay down the principal, which now stands at \$449.5 million. The increase in interest expense associated with this loan distorts inter-period comparisons. While the loan is certainly not to be ignored – prepayment penalties mean that it will likely remain outstanding for years – it can be dealt with separately for valuation purposes.

## VII. Company History: A Complex Capital Structure Emerges from the Financial Crisis

One of the complaints about JGW's shares is that the company's tangled history of financial distress and its current unusual holder base scare off new investors. KBW's initiation report, for example, cites as one of JGW's top "Investment Risks" its "Complex Ownership and Voting Structure with Larger Private Equity Concentration." Over time, such superficial concerns usually prove to be fleeting, but it's important to understand how JGW assumed its current form, even if only to conclude that it matters little to the company's fundamental value.

Established to pursue unrelated business opportunities, JGW pivoted and entered the fledgling structured-settlements market in 1995, helping to establish the current regulatory framework and becoming the number-one player. In [July 2005](#), the private-equity firm JLL Partners invested \$170 million to acquire a 70% stake in the company, with management taking the other 30%; by [2007](#), it had already extracted \$290 million in dividends, partially financed by the booming syndicated-loan market, and EBITDA was growing at over 25% a year.

But when the financial crisis hit, JGW found itself over-levered and, worse still, far too reliant on a single source of secured funding: Deutsche Bank. Given the consistently large spread between the price at which JGW acquired receivables from customers and the price at which it resold them via securitization, the company had, as a matter of course, been able to borrow more from its Deutsche Bank secured credit facility than it spent acquiring the settlements that went into the facility, and it relied on this excess cash flow to fund operating expenses. In effect, it was getting an advance on future securitization proceeds. But when securitization markets shut down even for JGW's high-quality deals, Deutsche Bank altered the facility's terms on the fly, dramatically marked down the underlying collateral, and issued a series of margin calls that drained JGW's liquidity and rendered it incapable of making the next interest payment on its \$325 million term loan. In May 2009, the company filed for bankruptcy. But because it was a pre-packaged bankruptcy, the business suffered as little disruption as possible: the lenders just exchanged their interests for an equity stake, while JLL injected an additional \$100 million of cash to keep the operations going.

By 2011, JGW was again on the offensive, acquiring Peachtree from Credit Suisse's private-equity unit. Since the acquisition was paid for in stock, not cash, Credit Suisse affiliates ended up retaining part of the resulting entity. In [2012](#), JLL reportedly sought to sell JGW and attracted tentative bids from the likes of Blackstone, Apollo, and TPG, but, having a well-informed sense of the firm's true value, chose not to accept their bids. Instead, it extracted cash from the company yet again by increasing its leverage with a \$575 million term loan and paying out a dividend to equity holders; then, it decided to take JGW public, using the proceeds in part to pay down this same loan.

Even after the IPO, however, JLL and other legacy holders were set to have an outsized influence over JGW's fate, with a 62% economic interest in the firm's key operating subsidiary, 93% of the voting rights of the publicly traded holding company, and the power to name five directors to the board (subject to shareholder approval, which, given the other special privileges, is assured).

#### ***JGW Shareholder Breakdown***

Group	% Economic Interest in Opco	% Voting Rights of Holdco
JLL Affiliates	31.6%	61.8%
Credit Suisse Affiliates	14.7%	0.0%
JGW Employees	6.9%	13.5%
Other Holders (Incl. Pre-BK Lenders)	8.8%	17.3%
Subtotal	62.1%	92.6%
<b>Public Investors</b>	<b>37.9%</b>	<b>7.4%</b>
Total	100.0%	100.0%

*Source: JGW filings*

Over time, this structure will migrate toward normalcy, since the legacy holders have the ability (but no obligation) to convert their equity interests into publicly traded Class A shares on the following schedule:

#### ***JGW Lock-Up Expiration Schedule***

Date	Shares Unlocking	% of Total
Feb. 6, 2014	853,719	4.6%
Mar. 24, 2014	853,719	4.6%
May 24, 2014	16,658,697	90.7%

*Source: JGW filings*

Still, for equity investors looking for a reason to ignore a small specialty-finance IPO involving an unfamiliar business model, “private-equity overhang” and “lock-up expirations” are perfect excuses. Whatever the cause, JGW’s IPO [performed poorly in initial trading](#): after setting a price range of \$19 to \$22 but failing to elicit enough investor interest, the underwriters shrunk the number of shares offered by 20% (eliminating the secondary component) and cut the range to \$15 to \$16. In the end, JGW could only clear the market at \$14, a significant 32% discount to the mid-point of the original range. JLL took advantage of the weak pricing and supported the deal by acquiring another 1.5 million shares at a net price of \$13.125. Due to the unique circumstances and likely side-pocket nature of the 1.5mm share investment, JLL chose to distribute those newly acquired shares to LPs [as of February 5th](#).

Though the stock price has rallied from its opening day low of \$12.50, it has still yet to break into the originally contemplated IPO range of \$19 to \$22. Thanks to the high level of continued private-equity ownership and the onset of the lock-up expirations, the stock continues to suffer from “technical” selling pressure or the fear thereof; traders are reluctant to buy in front of a large potential secondary offering from JLL or Credit Suisse. But it’s precisely this dynamic that creates the opportunity for more patient investors to acquire a leading consumer-finance franchise at a bargain valuation; by the time the overhang is clearly gone, it may be too late to act.

### ***JGW’s Funding Arrangements Reflect the Lessons Learned in Bankruptcy***

A more fundamental question raised by a review of JGW’s corporate history is what prevents the firm from once again running into trouble in the event of a credit crunch. Given its continued reliance on wholesale funding to generate cash, JGW is certainly exposed to this risk, and a sufficiently severe replay of, say, the failure of Lehman Brothers would undoubtedly do damage.

Nonetheless, the company has come a long way from its pre-bankruptcy days. Instead of relying on a single \$250-million Deutsche Bank warehouse facility, JGW now uses five lenders for pre-securitization funding with aggregate capacity of \$750 million – and no provisions for mark-to-market margin calls or discretionary changes in advance rates. The facilities are also longer-dated, lasting at least two years and then amortizing over at least 18 months. Furthermore, while JGW’s crisis-driven bankruptcy hurt the holders of its corporate debt and equity securities, as discussed above, the firm’s asset-backed issuances were never impaired and never missed any payments; as a result, it’s at least plausible that funding availability will be stronger in the next credit debacle than it was in the last one. Additionally, JGW has focused more management energy on funding issues, with a dedicated chief investment officer overseeing the details and a relatively new CFO, hired from outside the firm in April 2013.

## VIII. JGW's Business Model Has Full Judicial Support

In the current regulatory climate, anyone purporting to offer “cash now” to needy consumers faces harsh scrutiny not just from policymakers but from investors. JGW, however, has the benefit of a stable and time-tested legal framework for structured-settlement transfers that lends legitimacy to each and every one of its purchases. The same can't be said for even mainstream financial products like credit cards.

In the 1990s, when structured settlements were themselves a relatively novel concept, a nascent industry arose to provide claimants with liquidity, but legislators grew concerned that, without more oversight, unscrupulous buyers could fleece unwary claimants by charging exorbitant discount rates; reckless claimants might also subvert the original policy purpose of structured settlements by quickly extracting the value of their payment streams and spending it on frivolities. In response to these concerns, state legislatures began in 1997 to adopt “Structured Settlement Protection Acts” (SSPAs), almost all of which are derived from a single uniform model statute, albeit with minor variations. The key provision of the SSPAs is a requirement that any valid transfer *must be approved in advance by a judge*. Congress reinforced this state-level regime in 2001 with what is now Internal Revenue Code 5891, which imposes a 40% excise tax on any structured-settlement transfer not pre-approved by a court. Any valid court [order](#) must expressly find that the proposed transfer “is in the best interest of the payee, taking into account the welfare and support of the payee’s dependents.” A 2005 [Judges’ Journal article](#) provides a good summary of the origins of this rule.

This “best interest” requirement sets a high bar for JGW and its peers, and because they know that questionable transfers will get rejected in court, they have no incentive to pursue them and risk wasting their time. Spendthrift homeowners don’t have to answer any questions when they draw on home-equity lines to buy speedboats or flat-screen TVs, but structured-settlement claimants are at the mercy of their judges. Whatever one might think about this paternalistic system, it has the virtue, for JGW, of insuring that the industry is relatively wholesome. In a random sample of JGW transactions, two thirds of the sellers used the proceeds to pay down debt or to help with housing costs (for example, a down payment or moving expenses):

**ILLUSTRATIVE USE OF PROCEEDS <sup>1</sup>**

Debt Repayment / Pay Bills	36%
Housing-Related	31%
Transportation	7%
Education	6%
Miscellaneous	6%
Health Care	5%
Major Purchase	4%
Child Care	3%
Business-Related	3%

1) Source: Based on a random sample of 584 JG Wentworth transactions.

Source: JGW presentation, January 2014

Court approval is no mere rubber stamp; judges typically hold in-person hearings and question claimants directly to assess their level of competence. Furthermore, SSPAs often require that claimants (“payees” in this context) either obtain professional advice about the wisdom of selling their payment streams or explicitly waive such advice; in any case, they receive detailed disclosures laying bare exactly what discount rate the proposed buyer is applying to their payments and even what the present value of those payments would be under a (currently quite low) federally stipulated “[Applicable Federal Rate](#).” Below is a real example of what part of a typical disclosure form looks like:



*JGW Disclosure Form for a Structured-Settlement Transfer in South Carolina*

Account ID 360358  
July 2, 2012

**The aggregate amount of the Purchased Payments is \$38,000.00.**

**The discounted present value of the aggregate Purchased Payments at the federal interest rate of 1.20% is \$34,674.57. The discounted present value is the calculation of the current value of the transferred structured settlement payments (Purchased Payments) under federal standards for valuing annuities.**

**The gross amount payable to seller (You) is \$12,000.00.**

**No other expenses are incurred by You.**

**The net amount payable to the seller (You) is \$12,000.00.**

**Based on the net amount that You will receive in payment from Us and the amounts and timing of the structured settlement payments that You are selling to Us, this is the equivalent of interest payments to Us at a rate of 16.79% per year. PLEASE NOTE THAT THIS IS NOT A LOAN, BUT A SALE OF PAYMENT RIGHTS AND THE INTEREST FIGURE IS ONLY PROVIDED AS AN ILLUSTRATION OF THE ECONOMIC IMPACT OF THE SALE.**

**Notice of Cancellation Rights:**

**You may cancel without penalty or further obligation, not later than the fifth business day after Your receipt of payment from Us under the transfer agreement (Purchase Contract).**

**Please be advised there are no penalties or liquidated damages payable by You in the event of any breach of the transfer agreement (Purchase Contract) by You.**

**By signing below, You are confirming receipt of this Disclosure Statement at least 3 days prior to You executing the transfer agreement (Purchase Contract).**

  
TANISHA GANTT



Source: [Charleston County, South Carolina, Court of Common Pleas](#)

Arguably this disclosure format is unfair to JGW because, by using a very low annuity rate to value the payments, it inflates their real worth – it's not as if anyone would actually be willing to fund this transaction at a 1.2% discount rate. Still, Tanisha Gantt decided that this was her best

option, and Judge Roger M. Young ultimately agreed, notwithstanding, based on the text of his order, a rather skeptical attitude:

10. The Court questioned Payee at length about her understanding of the transaction.

11. In particular, the Court emphasized to Payee that she was selling a portion of her structured settlement at a discount rate of 16.79% while the applicable federal rate is only 1.20%.

12. The Court also questioned Payee about alternate sources of funds such as loans from financial institutions where the costs to Payee would be less than contemplated under the agreement.

13. Payee appeared knowledgeable about alternative sources of financing but preferred that the Court approve the transaction and allow her to sell a portion of her structured settlement.

14. Payee has no minor dependents.

15. Payee appears to be fully aware of the details of the proposed transaction and understands the significance of the high discount at which she seeks to sell a portion of her structured settlement.

16. From the testimony of Payee, the Court finds that approval of this transaction is in the best interests of Payee, taking into account the welfare and support of Payee's dependents, if any.

*Source: [Charleston County, South Carolina, Court of Common Pleas](#)*

In light of the already intense judicial oversight of the transfer process, we don't foresee a regulator like the Consumer Financial Protection Bureau investigating JGW or other structured settlement liquidity providers.

## IX. Conclusion

JGW is the leading player in its industry, with 60-70% market share, a well-established consumer brand, and unparalleled operational expertise. Its ability to tap the securitization market gives it an attractive cost advantage over competitors. The Company generates enviable returns on investment in its core business and has clear opportunities to grow, both through accretive acquisitions and expansion into adjacent areas. Yet the market values JGW like a distressed firm with an obsolete business model.

We attribute the disconnect between JGW's low market price and its far higher intrinsic value, which we estimate to be almost \$30, to the lingering effects of its unsuccessful IPO, concerns about future lock-up expirations, and the company's complex accounting. JGW may also suffer from its obscurity, low float, and unfamiliar business model. But these technical and presentation-oriented factors have no bearing on JGW's underlying fundamentals, which remain strong. We believe that buying a dominant consumer-finance franchise at such a discounted

valuation offers an attractive risk/reward trade-off. Investors who recognize JGW's value but wait too long to act may discover that by the time the technical issues have been resolved and the market becomes comfortable with the company's accounting, it will be too late: the market may have already bid the price materially higher.

## X. Full Legal Disclaimer

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# Appendix A. Illustrative Analysis of JGW's Tax Advantages

## Cash Flows by Year

	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	Total
Payments Received		4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	100.0%
Carrying Value at Purch. Rate	33.9%	33.6%	33.3%	32.9%	32.5%	32.0%	31.5%	31.0%	30.3%	29.7%	28.9%	28.0%	27.1%	26.1%	24.9%	23.6%	22.2%	20.6%	18.9%	17.0%	14.8%	12.4%	9.8%	6.9%	3.6%	0.0%	
Interest Component		3.7%	3.7%	3.6%	3.6%	3.5%	3.5%	3.4%	3.4%	3.3%	3.2%	3.2%	3.1%	3.0%	2.8%	2.7%	2.6%	2.4%	2.3%	2.1%	1.9%	1.6%	1.4%	1.1%	0.7%	0.4%	66.1%
Principal Component		0.3%	0.3%	0.4%	0.4%	0.5%	0.5%	0.6%	0.6%	0.7%	0.8%	0.8%	0.9%	1.0%	1.2%	1.3%	1.4%	1.6%	1.7%	1.9%	2.1%	2.4%	2.6%	2.9%	3.3%	3.6%	33.9%

## Securitization structure

### Simplified Waterfall:

Bond Interest	2.4%	2.3%	2.2%	2.2%	2.1%	2.0%	1.9%	1.9%	1.8%	1.7%	1.6%	1.5%	1.4%	1.3%	1.2%	1.1%	1.0%	0.9%	0.7%	0.6%	0.5%	0.3%	0.2%	0.0%	0.0%	32.8%	
Residual Interest	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	3.5%	
Bond Principal	1.5%	1.6%	1.6%	1.7%	1.8%	1.8%	1.9%	2.0%	2.1%	2.2%	2.2%	2.3%	2.4%	2.5%	2.6%	2.8%	2.9%	3.0%	3.1%	3.3%	3.4%	3.5%	3.7%	0.3%	0.0%	56.2%	
Residual Principal	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	3.5%	4.0%	7.5%
Total	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	100.0%
Total Cash to Residual	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	3.7%	4.0%	11.0%

### At End of Period

Bond Principal	56%	55%	53%	52%	50%	48%	46%	44%	42%	40%	38%	36%	34%	31%	29%	26%	23%	20%	17%	14%	11%	8%	4%	0%	0%	0%
Residual "Principal"	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	0%	0%	0%

## JGW Economics

Purchase	-33.9%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Advertising	-6.0%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Cash Opex	-8.0%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Cash Invested	-47.9%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-47.9%
Cash Proceeds from Funding	56.2%																										56.2%
Cash Proceeds from Resid.		0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	3.7%	4.0%	11.0%
Underwriting/Legal Fees	-0.8%																										-0.8%
Restricted Cash	-1.0%																										1.0%
Total Pre-Tax Cash Flow	6.4%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	3.7%	5.0%	18.5%
Cumulative	6.4%	6.6%	6.7%	6.9%	7.0%	7.1%	7.3%	7.4%	7.6%	7.7%	7.9%	8.0%	8.2%	8.3%	8.5%	8.6%	8.8%	8.9%	9.1%	9.2%	9.3%	9.5%	9.6%	9.8%	13.5%	18.5%	

### For Tax Purposes:

Interest Income	-	3.7%	3.7%	3.6%	3.6%	3.5%	3.5%	3.4%	3.4%	3.3%	3.2%	3.2%	3.1%	3.0%	2.8%	2.7%	2.6%	2.4%	2.3%	2.1%	1.9%	1.6%	1.4%	1.1%	0.7%	0.4%	66%
Interest Expense	-	2.4%	2.3%	2.2%	2.2%	2.1%	2.0%	1.9%	1.9%	1.8%	1.7%	1.6%	1.5%	1.4%	1.3%	1.2%	1.1%	1.0%	0.9%	0.7%	0.6%	0.5%	0.3%	0.2%	0.0%	0.0%	33%
Net Interest Income	-	1.3%	1.4%	1.4%	1.4%	1.4%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.6%	1.5%	1.5%	1.5%	1.5%	1.5%	1.4%	1.3%	1.3%	1.2%	1.0%	0.9%	0.7%	0.4%	33%
Expenses	-14.9%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-15%
Taxable Income	-14.9%	1.3%	1.4%	1.4%	1.4%	1.4%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.6%	1.5%	1.5%	1.5%	1.5%	1.5%	1.4%	1.3%	1.3%	1.2%	1.0%	0.9%	0.7%	0.4%	18.5%
Cumulative	-14.9%	-13.6%	-12.2%	-10.8%	-9.4%	-7.9%	-6.5%	-5.0%	-3.5%	-1.9%	-0.4%	1.1%	2.7%	4.2%	5.8%	7.3%	8.8%	10.2%	11.6%	13.0%	14.2%	15.4%	16.4%	17.3%	18.1%	18.5%	

Tax Rate	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	
Taxes Accrued	-5.7%	0.5%	0.5%	0.5%	0.5%	0.5%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.5%	0.5%	0.5%	0.4%	0.4%	0.3%	0.3%	0.1%	7.0%
NOL Consumption	-5.7%	0.5%	0.5%	0.5%	0.5%	0.5%	0.6%	0.6%	0.6%	0.6%	0.6%	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
NOL Ending Balance	5.7%	5.2%	4.6%	4.1%	3.6%	3.0%	2.5%	1.9%	1.3%	0.7%	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Cash Taxes Paid	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.4%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.5%	0.5%	0.5%	0.4%	0.4%	0.3%	0.3%	0.1%	7.0%
Total After-Tax Cash Flow	6.4%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	-0.3%	-0.4%	-0.4%	-0.4%	-0.4%	-0.4%	-0.4%	-0.4%	-0.4%	-0.3%	-0.3%	-0.2%	-0.2%	3.4%	4.9%	11.4%

Pre-Tax NPV	8.6%
After-Tax NPV	6.7%
Discount Rate Assumed	8.0%
Overall Economic Tax Rate	21%

Source: JGW filings, Kerrisdale analysis

Assumptions: purchase discount rate = 10.92%; securitization discount rate = 4.37%; bond coupon = 4.21%; residual coupon = 3.75%; total bonds = 93.5% of PV of payments at securitization discount rate; statutory tax rate = 38%; underwriting/legal fees = 1.5% of bond proceeds; restricted cash = 1.0% of bond proceeds.