

THE SCHADENFREUDE TRADE

IMPERIAL HOLDINGS (TICKER: IFT)

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BACKGROUND

- On June 30, 2012 (date of latest available financial statements) Imperial Holdings had net assets 92% higher than the current market capitalization: \$161 million¹ vs. \$84 million²
- There are substantial contingent assets off-balance sheet, and zero debt
- Using a probabilistic analysis of Imperial's assets, we have determined that the company's shares are deeply undervalued
- Bulldog Investors, an activist investment firm, has taken control of the board of directors in order to close the gap between net asset value and market capitalization

¹ Imperial Holdings Q2 2012 Form 10-Q

² Market price current as of December 7, 2012

WHAT ARE THE ASSETS?

- Imperial's largest asset is a portfolio of life policies marked at \$110.6 million
- Investments in life policies are uncorrelated with stocks, bonds, real estate, etc. When an insured dies, the life insurer pays the death benefit to Imperial
- Since everyone must die someday, investors in life insurance policies are guaranteed¹ a payout
- All the investor has to do is pay premiums to the life insurer to keep policies in force; Imperial makes premium payments every month, and has 100% of its policies in force

¹ See appendix on penultimate slide for more information

WHAT ARE THE ASSETS WORTH?

- Valuing a portfolio of life insurance policies is an exercise in probability; the larger the number of insurance policies, the likelier it is to reach an accurate valuation
- Imperial owns 204 policies, with the average insured being 78 1/2 years old¹
- Using conservative actuarial models from a third party life expectancy provider, Imperial expects the average insured to live another 10.6 years
- Insurers include Lincoln National Life, ReliaStar Life, Sunlife Assurance, and AXA Equitable; we believe these life insurers have adequate financial strength to meet obligations to Imperial

¹ Imperial Holdings Q2 2012 Form 10-Q

CONSERVATIVE LIFE EXPECTANCIES

- In pricing trades many market participants reference a table developed by the U.S. Society of Actuaries known as the 2008 Valuation Basic Table
- Imperial uses a more conservative method to value its life settlements. It applies the mortality experience of an insured population that is representative of participants in the life settlement market. Because of the relative greater wealth of the participants in the life settlement market, and thus their access to superior healthcare, these individuals tend to live longer than the general population.¹

¹ Imperial Holdings 2011 Form 10-K

SENSITIVITY ANALYSIS

- If all of the insureds in Imperial's portfolio live six months shorter or longer than the life expectancies provided by third party life expectancy providers, the change in fair market value would be:

LE Months Adjustment	Value	Change in Value
+6	92,701	-17,909
	110,610	
-6	130,902	20,292

- In the highly unlikely event that the insureds in aggregate live six months longer than expected, fair market value would decrease by \$18 million

CONSERVATIVE DISCOUNT RATES

- Historically, Imperial used discount rates of 15 - 17.5% in its fair value model for investments in life settlements
- After the US Attorney's Office investigation in Q3 2011, however, the Company increased its weighted average discount rate to 24.31% due to negative perceptions held by other market participants in transacting with the company
- Imperial entered into a non-prosecution agreement with the USAO in Q2 2012, and thereafter began to transact with market participants

DISCOUNT RATE ANALYSIS

- We believe that Imperial's 24.31% discount rate is too high, given that risks have decreased
- A drop in the discount rate by just 0.5% would dramatically increase the fair value of Imperial's life insurance portfolio¹

<u>Wtd. Agv Rate</u>	<u>Rate Adj.</u>	<u>Value</u>	<u>Change in Value</u>
23.81%	-.50%	93,433,348	2,516,098
24.31%	—	90,917,250	—
24.81%	+.50%	88,282,240	(2,635,010)

- The discount rate is likely to be lowered in future financial filings, namely, the Q1 2013 Form 10-Q

¹ Imperial Holdings 2011 Form 10-K

HISTORICALLY CONSERVATIVE

- “During the years ended December 31, 2011 and 2010, the Company earned income of approximately \$570,000 and \$10.2 million, respectively on the unrealized changes in fair value of life insurance policies it acquired.”¹
- This indicates that Imperial is conservative in reporting the fair value of its life policies
- Either the insureds have been dying sooner than expected, Imperial’s discount rate has been too high, or both
- We believe that both factors are responsible, and Imperial will likely continue to report gains in unrealized changes in the fair value of its life policies

¹ Imperial Holdings 2011 Form 10-K

PAYING PREMIUMS

- In order to keep its life policies in force, Imperial must pay premiums to the insurers (estimated amounts in thousands):

2012	24,059
2013	24,553
2014	21,445
2015	22,247
2016	22,687
Thereafter	<u>269,478</u>
	<u>\$384,469</u>

- Management estimates that the portfolio will be cash flow neutral as early as 2014 (death benefit inflows will at least match premium payment outflows)
- Imperial had about \$50 million of cash and cash equivalents as of June 30, 2012--more than enough to pay premiums for 2013 as well as cover operating expenses. However, there is uncertainty over how Imperial is going to afford premium payments in subsequent years

CATALYST: PREMIUM FUNDING FACILITY

- Imperial has been seeking to raise more cash so that there is no doubt about its ability to pay premiums for the next several years
- Imperial has been working to secure a premium funding facility as an alternative to doing a secondary offering or bond offering
- Several parties have expressed interest in providing funding: hedge funds, commercial banks and insurance companies¹
- We believe that the settlement of the shareholder class action lawsuits (announced last December; scheduled for January 15, 2013) will allow management to better determine the appropriate fundraising amount and method

¹ Honne Capital conversations with Imperial Holdings management

OFF BALANCE SHEET ASSET

- Imperial services a portfolio of life settlements for AIG
- Imperial holds underlying title to the policies, but does not account for this on-balance sheet
- AIG makes the premium payments on the life settlement portfolio, and if someone in the pool dies, Imperial is the beneficiary after paying subrogation fees
- So far there have been two mortalities in the off-balance sheet portfolio, and Imperial has collected a windfall of ~\$10 million
- This off-balance sheet portfolio is bigger than the on-balance sheet portfolio

¹ Honne Capital conversations with Imperial Holdings management

PUTTING IT ALL TOGETHER

- Imperial owns a portfolio of life policies that it marks conservatively, assuming longer life expectancies than average
- Moreover Imperial discounts the policies at a 24% rate, which is 8 percentage points higher than usual; we expect this discount rate to drop in Q1 2013
- The \$110 million valuation of Imperial's life insurance portfolio is likely too low, and we expect an upward revision once management secures a premium funding facility¹
- Following the settlement of the shareholder class action lawsuits announced last December, we believe that the establishment of a premium funding facility is imminent

¹ Honne Capital conversations with Imperial Holdings CEO

APPENDIX: LEGAL ISSUES

- Life insurance companies have two years from the date of origination to contest the validity of a life policy. Once the two-year period passes, insurers are legally obligated to pay the death benefit upon death of the insured as long as the original beneficiary had an insurable interest in the policyholder
- In all of the policies owned by Imperial, the original beneficiary (either a spouse or child) did have an insurable interest in the policyholder
- All of Imperial's policies are beyond the two-year contestability period
- Life insurance companies are legally required to pay Imperial upon the death of each insured

Source: Imperial Holdings CEO

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