

August 12, 2011

Dear clients and colleagues,

More than \$8 trillion in value was erased from global stock markets between July 22 and August 8 in response to the euro zone sovereign debt crisis and mounting concerns that the global economy is slowing.

With a backdrop of market volatility, we continue to look for profitable investments in companies with good revenue growth, minimal risk and sustainable cash flow. Of particular interest is a publicly traded, consumer-oriented law firm with a recurring and non-discretionary business model.

This week we profile Slater & Gordon (SGH AU), the world's only publicly listed law firm.

#### ***Business overview and history***

Slater & Gordon was established in Melbourne in 1935, and progressively evolved into a consumer law firm. Ten years ago, the firm decided that Personal Injury was destined to become a specialized area of the law and as such set up a specialist practice group. Slater & Gordon was listed in Australia in May 2007.

The firm is one of the largest in Australia, with a network of 40 law offices throughout the country. About 80% of its business is Personal Injury. As it works on a no-win, no-fee basis, Slater & Gordon only takes on cases it believes it can win. The firm's success rate is more than 90%. Its call center attracts 70,000 enquiries per year.

#### ***The market***

Broader legal services are approximately A\$2.2bn industry in Australia. Personal Injury and Family Law cases account for 21% of industry revenue, and around 10% is represented by claims of Personal Injury and Workers Compensation. Currently, Slater & Gordon has 20% market share and plans to increase it to 30% by 2015.

"Tesco Law" in the UK will allow firms to sell equity shares in law firms to non-lawyers, effectively opening the market. This law will come into effect in October 2011. The UK market is five times that of Australia, and has a similar common law legal system. Slater & Gordon could enter the UK market in the future.

#### ***Competitive advantages and competition***

Major law firms like Clayton Utz, Freehills, Mallesons Stephen Jaques, Minter Ellison have a corporate focus.

The Personal Injury market in Australia is very fragmented with over 10,000 firms. The main rival in this market, Maurice Blackburn, is one third the size of Slater & Gordon with \$75M in revenues. Next in line is Shine and Turner Freeman in Queensland with revenues of \$50M. There are 5 other firms, such as Brydens and Firths, which earn in the range of \$5-10M, while the remaining firms are substantially smaller.

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Slater & Gordon is by far the largest law firm, which gives it a recognizable brand and the ability to continually attract new business. The long lag between when it does the work and when it gets paid is a barrier to entry for would-be competitors. Given its size it can buy up smaller competitors at attractive multiples of about three to four times earnings.

### ***Growth strategy***

Slater & Gordon has an organic growth of 6-8% in the Personal Injury business. In part, its growth has been a result of acquisitions. It has done more than 20 acquisitions since 2006 and has successfully integrated them. The risk associated with acquisition is lower among legal firms as compared to other businesses because the acquirer can see what business the target company has in its pipeline.

Acquisition helps increase market share, some of Slater & Gordon acquisition for e.g. Keddie's gave 10% market share in New South Wales. Trilby Misso, with 15 - 20% of market share, was the largest in Queensland, and added A\$30M in revenue with EBIT margin +30%.

The brand can be leveraged into emerging practices, which will help achieve the firm's goal of increasing its revenue to A\$300m by 2015 from the current A\$125M. Slater & Gordon has a strong focus on growing its market share and expanding its non-Personal Injury business to 40% from the current 25% by 2015. It also has strong relationships with 60 trade unions in Australia, which ensures a solid and consistent client base.

### ***Risks***

There is possible liquidity risk as there are only 155 million shares outstanding. Slater & Gordon could also encounter acquisition risk if it bought a firm that was too large and had trouble integrating it. There is also potential currency risk if the Australian dollar falls against its Canadian counterpart.

### ***Market data***

Market Cap A\$340M, P/E (2012) 9.1x, EV/EBITDA (2012) 6.1x, ROE 15.7%, dividend yield 3.4%, operating margin 24.5% and profit margin 16.2%. [www.slatergordon.com.au](http://www.slatergordon.com.au)

### ***Valuation***

We use a DCF model and derived a target price of A\$3.02.

Have a good weekend.

Regards,  
The Global Alpha Team

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