T11 Capital Management

One Park Plaza, Suite 600
Irvine, CA. 92614
tel: 949-441-5152 fax: 949-441-5099
www.T11Capital.com

email: mail@T11Capital.com

NAME: SIGNATURE GROUP HOLDINGS	SYMBOL: SGGH (OTC)
MARKET CAP (10/24/14): $118 MILLION	PRICE PER SHARE (10/24/14): 9.75
FLOAT: 10.23 MILLION	AVG VOLUME (3 MONTHS): 38,979

The Conclusion First

The conclusion with respect to SGGH will provide a frame of reference for the rest of the story. As I often like to do, the conclusion here certainly deserves to mentioned first.

The conclusion here is that investors are getting a tax efficient shell that has acquired its first business within a growth space that will propel the company into further acquisitions. The recently announced acquisition of Aleris Corporation's aluminum recycling division has not and cannot be digested by the market properly in order to provide a proper valuation. The unknowns with respect to cost of debt service, capex figures, future growth potential, margins and management plans to leverage this acquisition to further grow SGGH are too great. SGGH has little to no coverage and trades on the pink sheets, which further exacerbates the misvaluation of company shares.

The Acquisition

SGGH is an NOL shell with roughly $900 million in NOLs. On October 17th, 2014, they announced the an acquisition of Aleris Corporation's aluminum recycling division for $525 million:

Signature expects to finance the acquisition with a combination of cash on hand, and the net proceeds from debt and equity financings. This includes the issuance of approximately $300 million of senior secured bonds in a private placement to qualified institutional buyers and certain non-U.S. persons, as well as a registered offering of Signature's common stock, and a registered stapled rights offering of additional shares of its common stock to Signature stockholders at a date to be determined. A portion of the rights offering will be backstopped by Zell Credit Opportunities Fund, L.P., an affiliate of Equity Group Investments, a private investment firm founded by Sam Zell . In connection with the transaction, Goldman Sachs will lead a committed bridge financing with Deutsche Bank. General Electric Capital Corporation will provide a $175 million asset-based lending facility to finance the growth of the company. Those commitments are contingent on the satisfaction of standard conditions.

The Players

Sam Zell is the primary investor in SGGH since 2011, owning 9.3% of the company. This is an important point not because Zell is simply a savvy billionaire investor. Rather, Zell is a pioneer in the strategy of NOL cultivation. He has been an NOL investor since the early 80s when Congress changed the carryback/forward limits from 3 years to 15 years.

This excerpt from an interview with Zell in Graham & Doddsville:

In 1981 Congress changed the rules so that NOLs could be applied for up to fi fteen years. I looked at that and said "It went from three years to fi fteen years that dramatically changes their value". Yet when I looked at companies on the NYSE that had huge NOLs, they had not changed in value at all. So I went out and bought NOLs. I accumulated well over a billion dollars worth of NOLs and then went about creating businesses to absorb the NOLs.

More recently, Zell has been extremely successful with Covanta Corporation (CVA) rolling the NOLs from a bankrupt corporation in the early 2000s into a company that has a market cap of $2.8 billion and stock price appreciation of nearly 3000% over the past 10 years.

It is apparent that Zell has decided to utilize the same strategy with SGGH as he did at CVA. In fact, during the proxy process that ensued following the emergence from bankruptcy, CVA was explicitly cited as an example of successful emergence keying in on NOL cultivation.

This from the 2012 proxy:

Philip Tinkler is the Chief Operating and Financial Officer of Equity Group, Inc. ("EGI") and has been intimately involved in numerous acquisitions, restructurings, and operational turnarounds during his 22 year career working for Sam Zell (www.EGIZell.com). In addition to his responsibilities at EGI, Tinkler was CFO of Danielson Holding Corporation, an EGI portfolio investment and now known as Covanta Holding Corporation (NYSE:CVA), when Danielson acquired the Covanta business from bankruptcy. The Danielson/Covanta transaction was funded using a novel stapled rights offering which resulted in minimal ownership shift under the change of control tax rules. After the business was fully integrated Tinkler passed the CFO baton to the operating management team as the companies consolidated in the Covanta's offices.

http://www.sec.gov/Archives/edgar/data/38984/000119312512285761/d371556ddefa14a.htm

Additionally, Zell has taken the step of adding two board members to SGGH that are affiliated with CVA.

Phillip Tinkler is a key person inside Zell's corporation. He served as CFO of CVA for roughly one year as it emerged from bankruptcy. He was instrumental in developing the strategy that would turnaround CVA. He currently serves on the board of SGGH.

Peter Bynoe also serves on the board of SGGH. He is currently CEO of a Zell Corporation called "Rewards Network." Bynoe also served on the board of CVA.

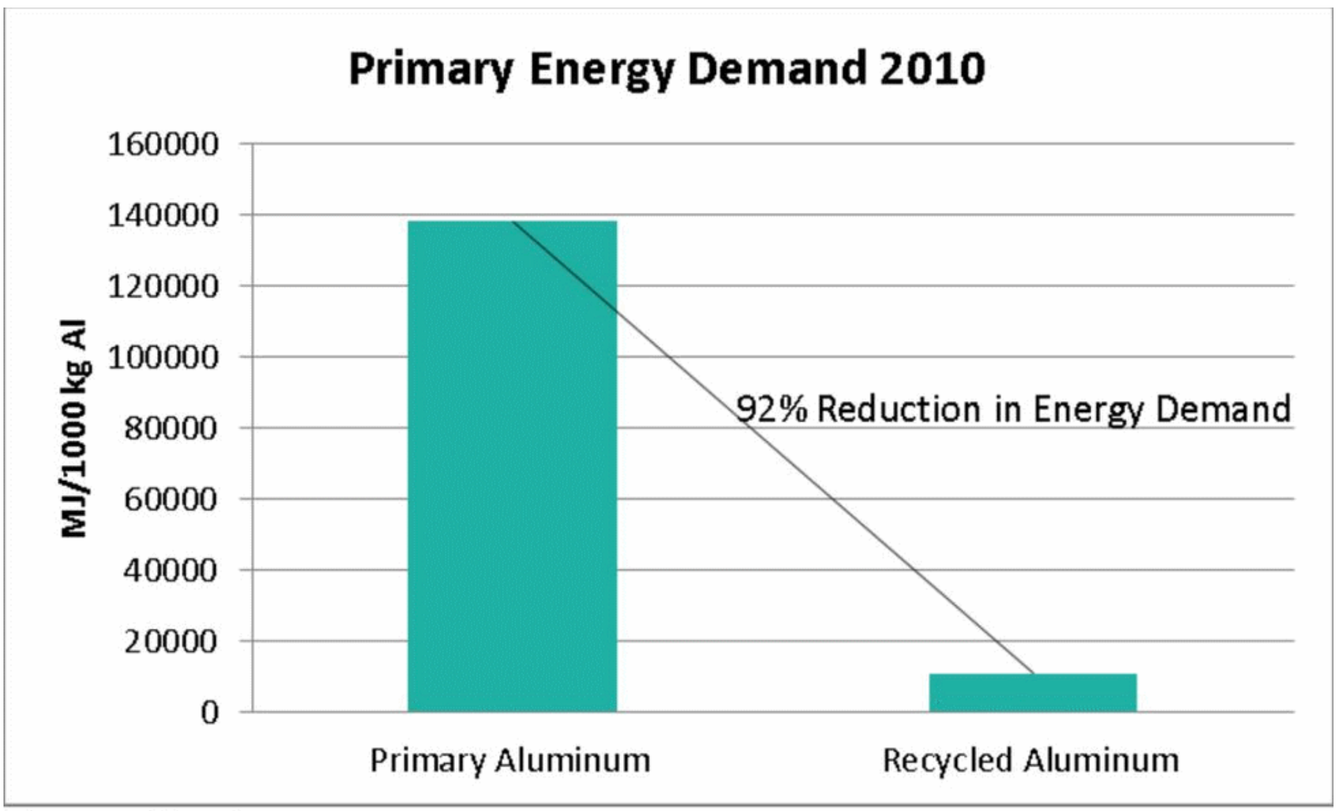
So you can see that Zell has very carefully crafted the board of SGGH to duplicate the success of CVA.

What are the pieces of evidence to suggest the path will be a successful one?

FIRST PIECE OF EVIDENCE: RECYCLED ALUMINUM IS POISED FOR GROWTH

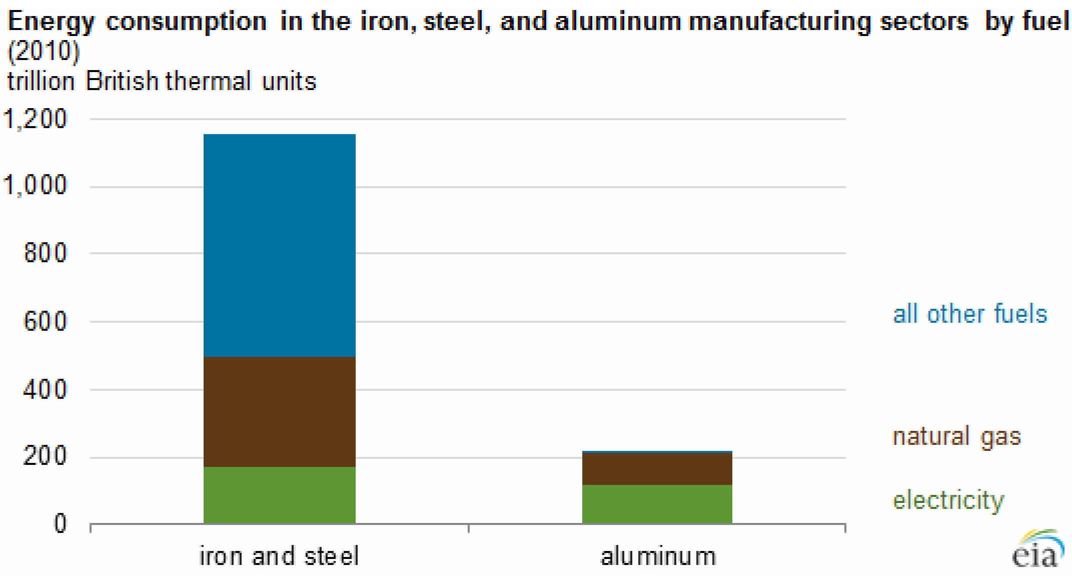
Recycled aluminum is a growth industry not because individuals are going to be increasing their consumption of Dr. Pepper, but rather, automobile manufacturers are being held to a higher standard of fuel efficiency. As such, they need a lighter material that doesn't compromise strength or safety. Tesla uses aluminum frames. The new Ford F-150 is the first Ford model to use an aluminum frame. Toyota is increasing use of aluminum in their automobiles. You get the picture. It is a sustainable trend in automobile manufacturing.

Recycled aluminum is preferred as aluminum can be recycled without compromising quality. There is no need to have "virgin" material. Recycled material also dramatically reduces energy demand in creating sheet as opposed to primary aluminum.

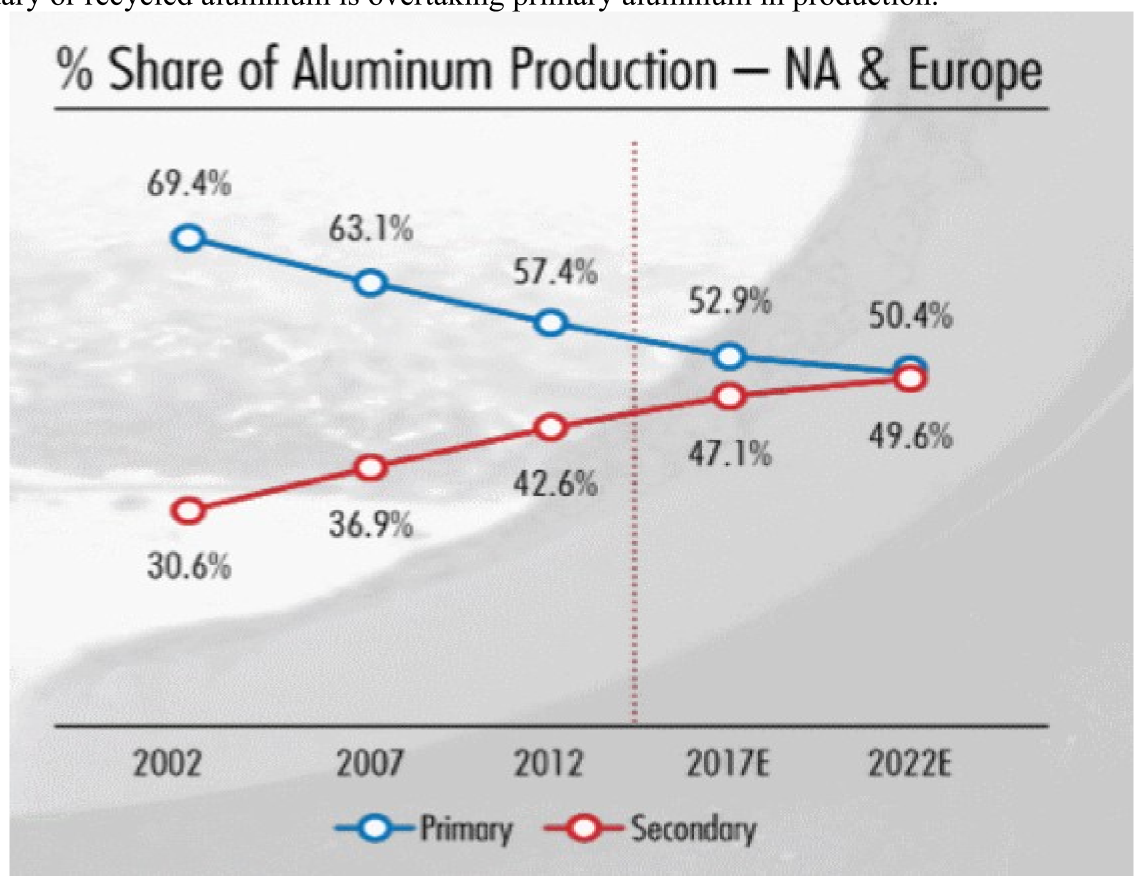


Source: Aluminum.org

The energy demand required for producing aluminum is far more efficient than iron & steel production.

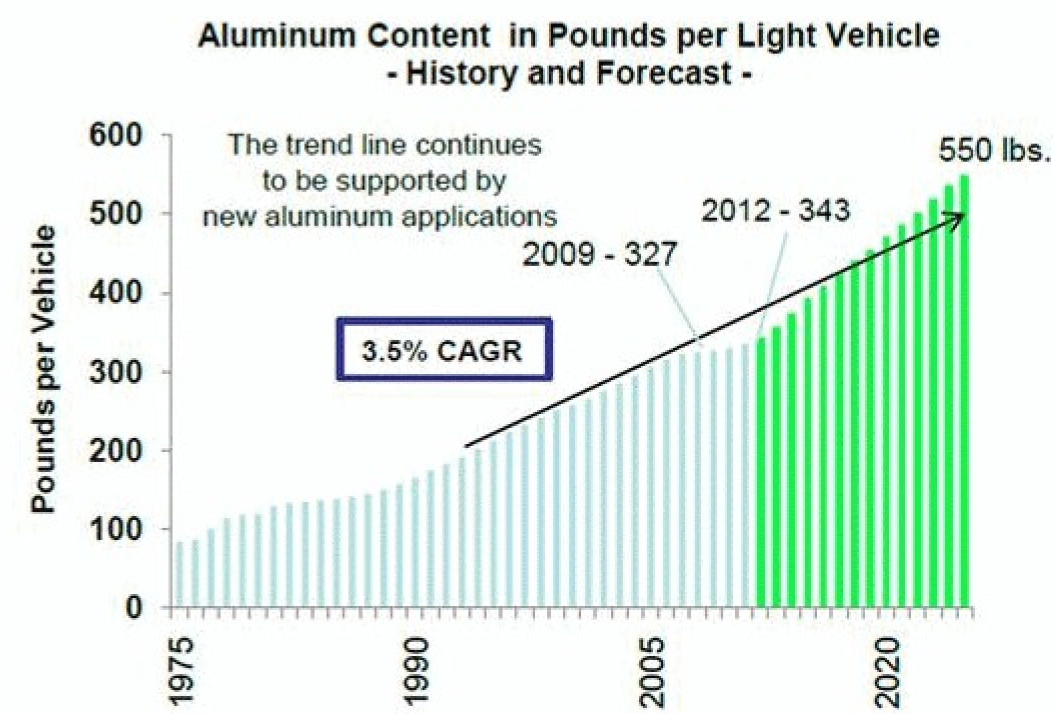


Secondary or recycled aluminum is overtaking primary aluminum in production.



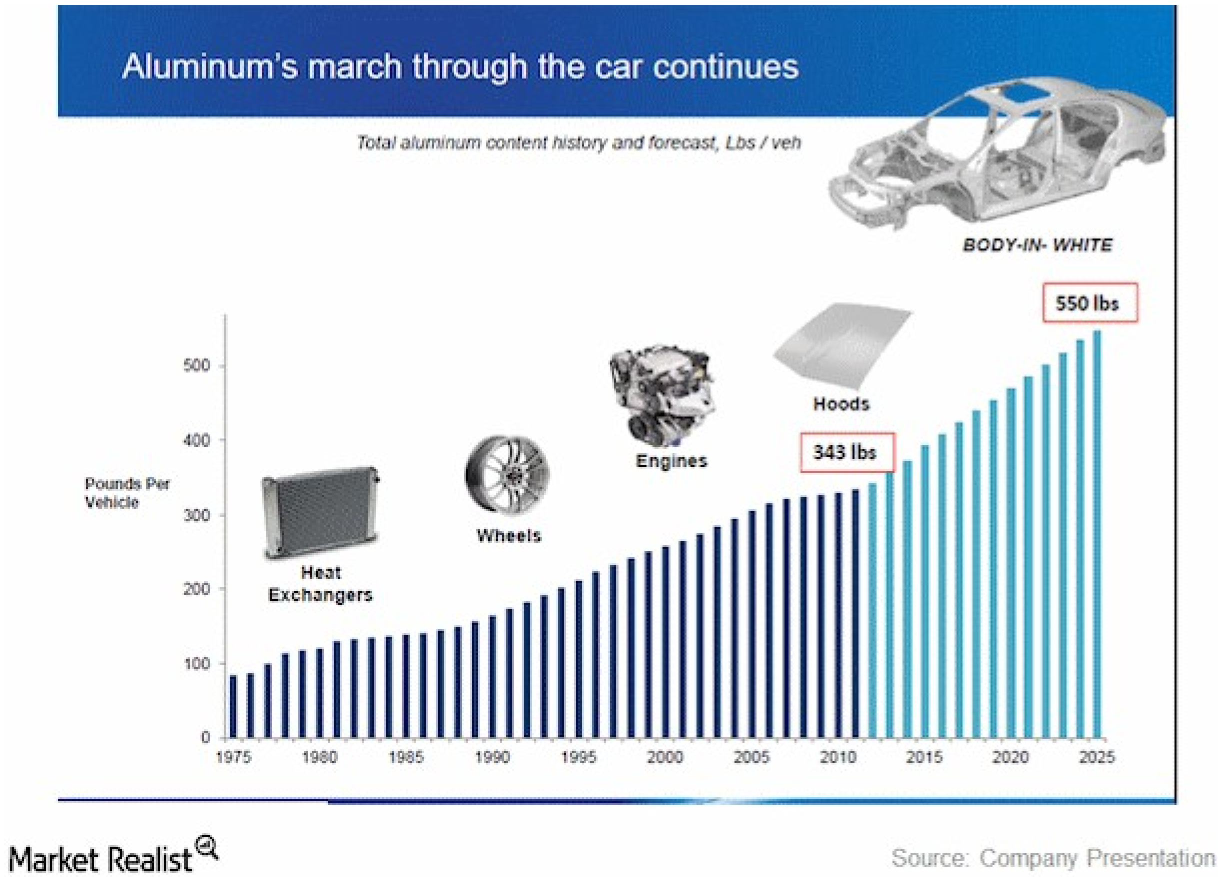
Aluminum sheet deliveries to auto makers are forecast to rise from 504 million pounds in 2014 to 2.7 billion pounds by 2018.

The aluminum content per vehicle has been steadily increasing over the years, with an acceleration projected to take place over the next decade.



Source: Drivealuminum.com

Aluminum has gone from simply being used in engines in wheels to now being used to construct entire frames for vehicles that create greater efficiencies while maintaining strength.



From ***'Difference Between Steel and Aluminum'****:*

•Steel strength over aluminum is almost the same, but steel is three times heavier than aluminum.

⇒ This is why the use of aluminum is so important in either fuel economy or in gaining range.

•Steel has a preserving quality, even after thousands of load cycles, but aluminum will fatigue and destroy.

⇒ So aluminum is usually extruded at roughly 20%-30% thicker than steel to guard against that eventuality.

•Aluminum has more malleability over steel, as it has more bending density compared with the density of steel.

⇒ This is what makes aluminum have better crumple zone reaction than steel, allowing for a safer vehicle to operate.

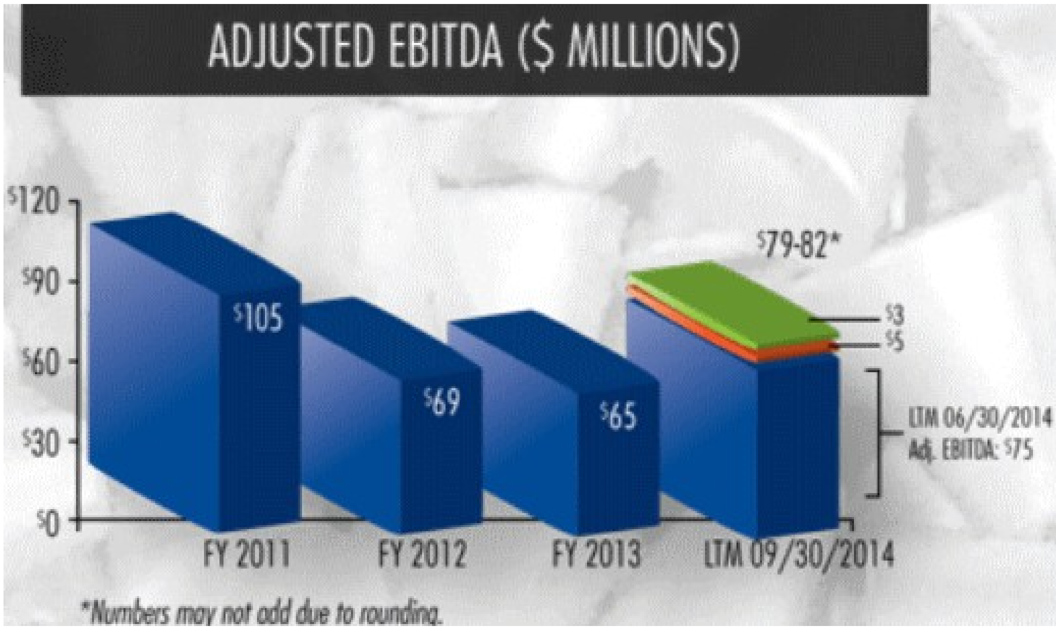
In a recent WSJ article, metals analyst Lloyd O'Carroll had this to say regarding the Ford F-150 being moved to an all-aluminum frame from steel:

An estimated 900 pounds of aluminum would be used to build the body of a full-size truck, compared with 1,500 pounds of steel, according to an analysis by Lloyd O'Carroll, a prominent metals analyst. Car makers don't disclose the amount of respective metals in their vehicles.
"This is a game changer," said Mr. O'Carroll. The market for body sheet aluminum is currently worth around $300 million a year. He said if other cars go all aluminum, by 2025 it could be over $7.5 billion, a godsend for an industry that has been dogged by oversupply and low raw aluminum prices.

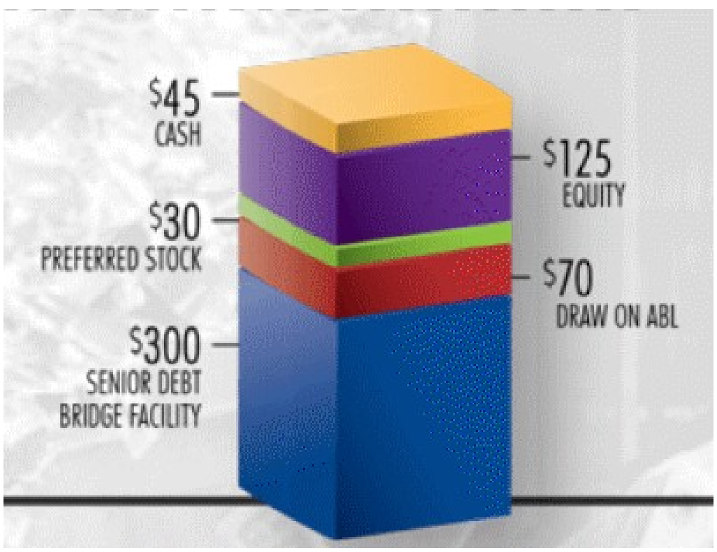
http://online.wsj.com/articles/SB10001424052702303754404579308471048401080

SECOND PIECE OF EVIDENCE: VALUE

SGGH is paying $525 million for a company with approximately $75 million in EBITDA in 2014. The high point of their EBITDA was $105 million in 2011 on revenues of approximately $1.6 billion. This is going to be financed with a combination of debt, preferred stock, cash and a rights offering, the details of which are yet to be announced. The cost of debt being taken on hasn't been announced. Even assuming the higher end of the rate spectrum 6-7% interest their senior facility, credit line etc. would equate to approximately $25-30 million in debt service per annum. Leaving the company with $45 million in earnings on the low end before CAPEX. This is a capital intensive business so I'm assuming that CAPEX as a percentage of EBITDA will be approximately 20-30 percent, which equates to roughly $20 million. Leaving the company with $25 million in cash flow. Meaning that at the current valuation the company is trading at approximately 4 times free cash flow (pre-equity/rights offering) based on the current earnings. *Charts from SGGH presentation.*



Total anticipated funding sources are as follows:



One of the key points to keep in mind with SGGH is that there are many unknown variables that make any type of modeling difficult. Once the company announces their first earnings report, we will get a much clearer picture that can then be used to model more accurate forecasts. We will get a feel for the potential of margin expansion, capex costs and measures to gain efficiency as well as growth. I expect that once these additional details become known, the stock price will react accordingly to the upside due to the disparity in value. This has been a trend in NOL shells in the past, where Wall Street is, for the most part, unaware of the potential in the company simply as a result of their first acquisition, instead waiting for earnings to begin properly valuing the company.

THIRD PIECE OF EVIDENCE: AN EXPERIENCED CEO

The CEO of the company, Craig Bouchard, is stellar. Craig Bouchard's father was a successful steel executive rising from the mail room at Inland Steel. In 2004, Craig Bouchard founded a steel company (Esmark) starting with revenues of $4 million and growing it through 9 separate acquisitions to a $3.5 billion company before it was acquired in 2008.

In the recent conference call for SGGH, following the acquisition, Bouchard said he wants to take a Warren Buffett approach to growing SGGH through multiple acquisitions over time. He has a track record of accomplishing this with Esmark. I expect similar results here.

Experience that comes from generational family expertise in an industry is invaluable and cannot be replicated easily. Bouchard has this advantage given the family history.

FOURTH PIECE OF EVIDENCE: MULTIPLE ACQUISITIONS

The business model here calls for multiple acquisitions. The structure of future acquisitions is impossible to estimate. However, what can be gained is that there are a considerable amount of NOLs that the newly-acquired business cannot efficiently run through. In order to exhaust the NOLs in what would ideally be a 5-7 year time frame, there will need to be add ons to profitability going forward. Those additional businesses will appear once debt from the current acquisition is reduced, allowing for additional leverage to be taken on.

The NOL model is built on leverage. In fact, NOLs are effectively leverage in profits that allows creative management teams to foster additional profitability that would otherwise be impeded by tax liability. This is an incredibly important point. And it is why NOL companies often times have exponential results in share price when guided by an experienced, aggressive brain trust.

FINAL CONCLUSION

Conventional opportunities in finance are opportunities in predictable outcomes. The predictably comes from pieces of data that are readily available, easy to research and interpreted by various analysts to give investors comfort in their choice of investment.

It is only when the variables involved in an opportunity are vast and the interpretation of what is to come is grounded in the abstract that the potential for gains that far exceed the average are attained.

While we do not know what form the future SGGH will take, we have tangible evidence that the first step taken is a proper one. We know that the potential for leveraged profitability exists as the company expands. We know that the CEO is acquisition minded, experienced and aggressive. We also know that the backers of the company are highly experienced in aggressive cultivation of tax attributes that has resulted in significant appreciation of public companies in the past, going back three decades.

Given the preponderance of evidence presented, an investment in SGGH has a significant possibility of being extremely profitable in nature.

LEGAL DISCLAIMER

As of the publication date of this report, T11 CAPITAL MANAGEMENT LLC and its affiliates (collectively "T11"), others that contributed research to this report and others that we have shared our research with (collectively, the "Authors") have long positions in the stock of the company covered herein (Signature Group) and stand to realize gains in the event that the price of the stock increases.

Following publication of the report, the Authors may transact in the securities of the company covered herein. All content in this report represent the opinions of T11. The Authors have obtained all information herein from sources they believe to be accurate and reliable. However, such information is presented "as is", without warranty of any kind – whether express or implied. The Authors make no representation, express or implied, as to the accuracy, timeliness, or completeness of any such information or with regard to the results obtained from its use. All expressions of opinion are subject to change without notice, and the Authors do not undertake to update or supplement this report or any information contained herein.

This document is for informational purposes only and it is not intended as an official confirmation of any transaction. All market prices, data and other information are not warranted as to completeness or accuracy and are subject to change without notice. The information included in this document is based upon selected public market data and reflects prevailing conditions and the Authors' views as of this date, all of which are accordingly subject to change. The Authors' opinions and estimates constitute a best efforts judgment and should be regarded as indicative, preliminary and for illustrative purposes only.

Any investment involves substantial risks, including, but not limited to, pricing volatility, inadequate liquidity, and the potential complete loss of principal. This report's estimated fundamental value only represents a best efforts estimate of the potential fundamental valuation of a specific security, and is not expressed as, or implied as, assessments of the quality of a security, a summary of past performance, or an actionable investment strategy for an investor. This document does not in any way constitute an offer or solicitation of an offer to buy or sell any investment, security, or commodity discussed herein or of any of the affiliates of the Authors. Also, this document does not in any way constitute an offer or solicitation of an offer to buy or sell any security in any jurisdiction in which such an offer would be unlawful under the securities laws of such jurisdiction. To the best of the Authors' abilities and beliefs, all information contained herein is accurate and reliable. The Authors reserve the rights for their affiliates, officers, and employees to hold cash or derivative positions in any company discussed in this document at any time. As of the original publication date of this document, investors should assume that the Authors are long shares of SGGH and stand to potentially realize gains in the event that the market valuation of the company's common equity is higher than prior to the original publication date. These affiliates, officers, and individuals shall have no obligation to inform any investor about their historical, current, and future trading activities. In addition, the Authors may benefit from any change in the valuation of any other companies, securities, or commodities discussed in this document. The compensation structure for the Authors' analysts is generally a derivative of their effectiveness in generating and communicating new investment ideas and the performance of recommended strategies for the Authors. This could represent a potential conflict of interest in the statements and opinions in the Authors' documents.

The information contained in this document may include, or incorporate by reference, forward looking statements, which would include any statements that are not statements of historical fact. Any or all of the Authors' forward-looking assumptions, expectations, projections, intentions or beliefs about future events may turn out to be wrong. These forward-looking statements can be affected by inaccurate assumptions or by known or unknown risks, uncertainties and other factors, most of which are beyond the Authors' control. Investors should conduct independent due diligence, with assistance from professional financial, legal and tax experts, on all securities, companies, and commodities discussed in this document and develop a stand-alone judgment of the relevant markets prior to making any investment decision.