STOCK PITCH | JULY 2023

Fineos

Substantial margin improvement ahead; shares are cheap.

Morningstar Equity Research

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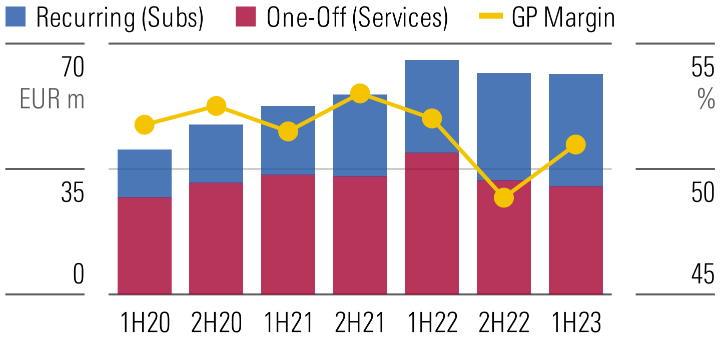
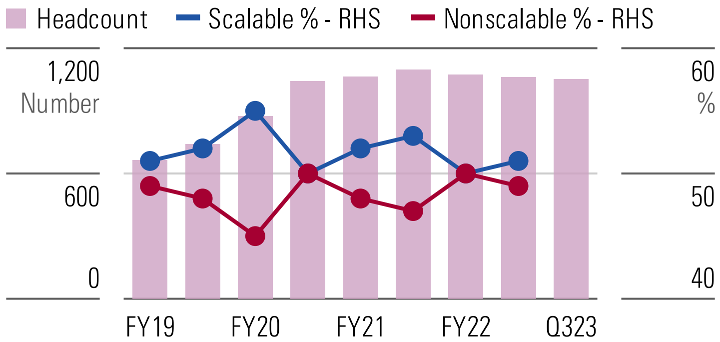
Positive Mix Shift, Labour Efficiency, and Cross-Selling to Improve Margins

Recurring Revenue Growing



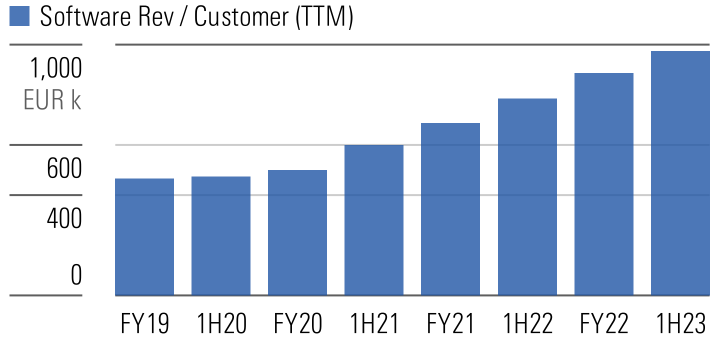
Source: Morningstar, Company Filings. Data as of Dec. 31, 2022.

Labour Efficiency Improving



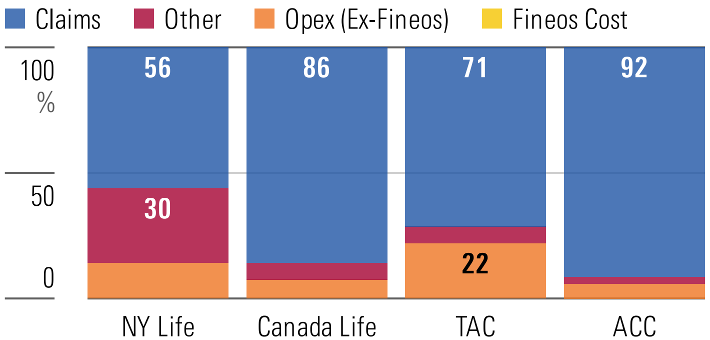
Source: Morningstar, Company Filings. Data as of May 31, 2023.

Customers Paying More



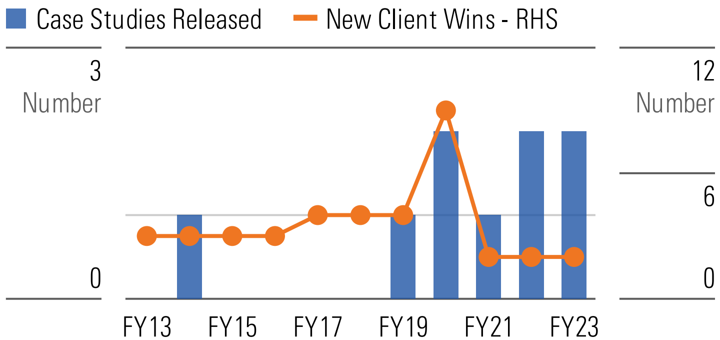
Source: Morningstar, Company Filings. Data as of Dec. 31, 2022.

Small Overall Cost to Clients Supports Fee Increases



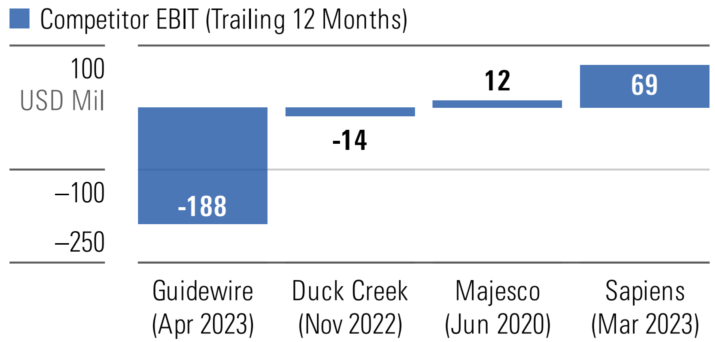
Source: Morningstar, Company Filings. Data as of Dec. 31, 2022.

Client Advocacy Enables New Business Wins



Source: Morningstar. Data as of May 31, 2023.

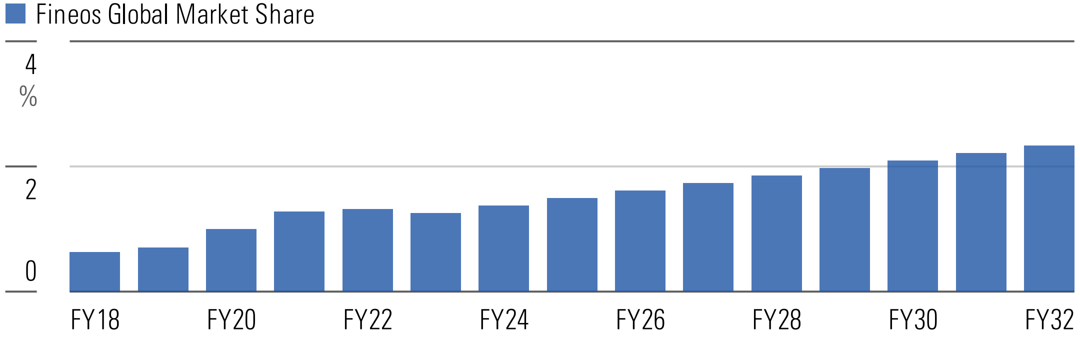
Peer Rivalry Has Likely Limited Lack of Profitability



Source: Morningstar, Company Filings. Data as of April 30, 2023.

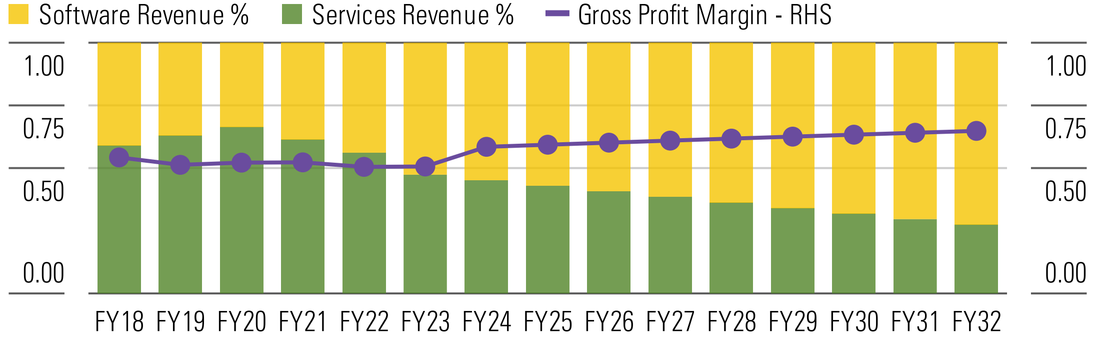
Market Underestimates Future Margins and Cash Flows

Share Gains Fuelled by Cross-Selling



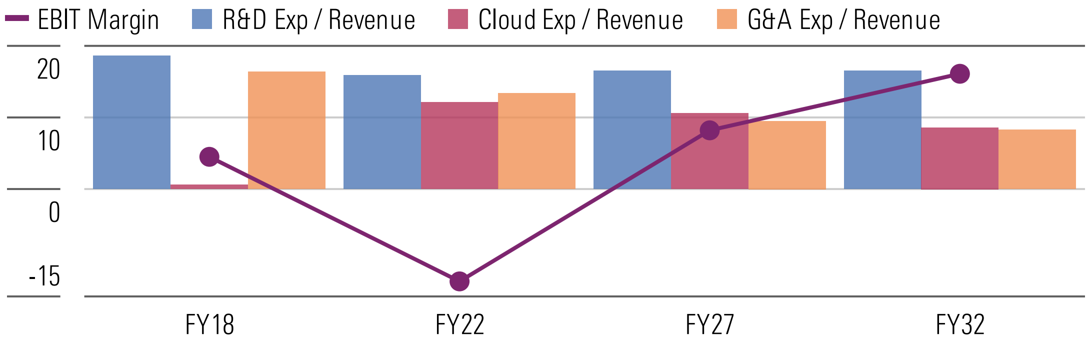
Source: Morningstar. Data as of May 31, 2023.

More Recurring Revenue Set To Boost Margins



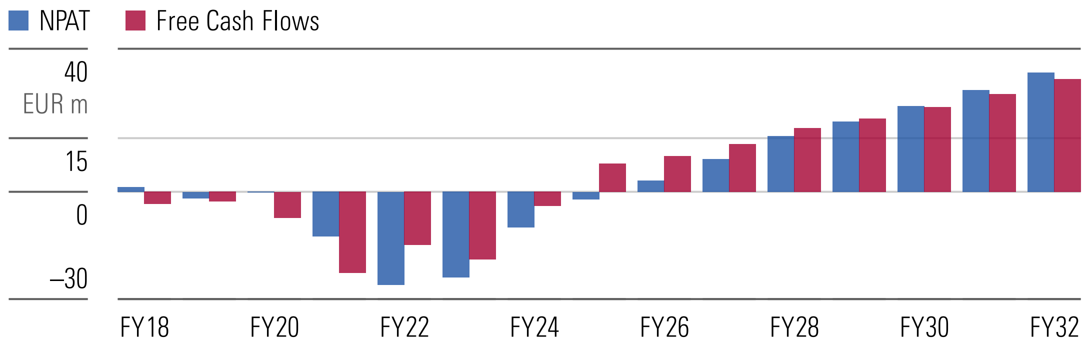
Source: Morningstar, Company Filings. Data as of May 31, 2023.

Margins To Grow as Fixed Costs Scale



Source: Morningstar, Company Filings. Data as of May 31, 2023.

Significant Improvement Expected Without Additional Equity

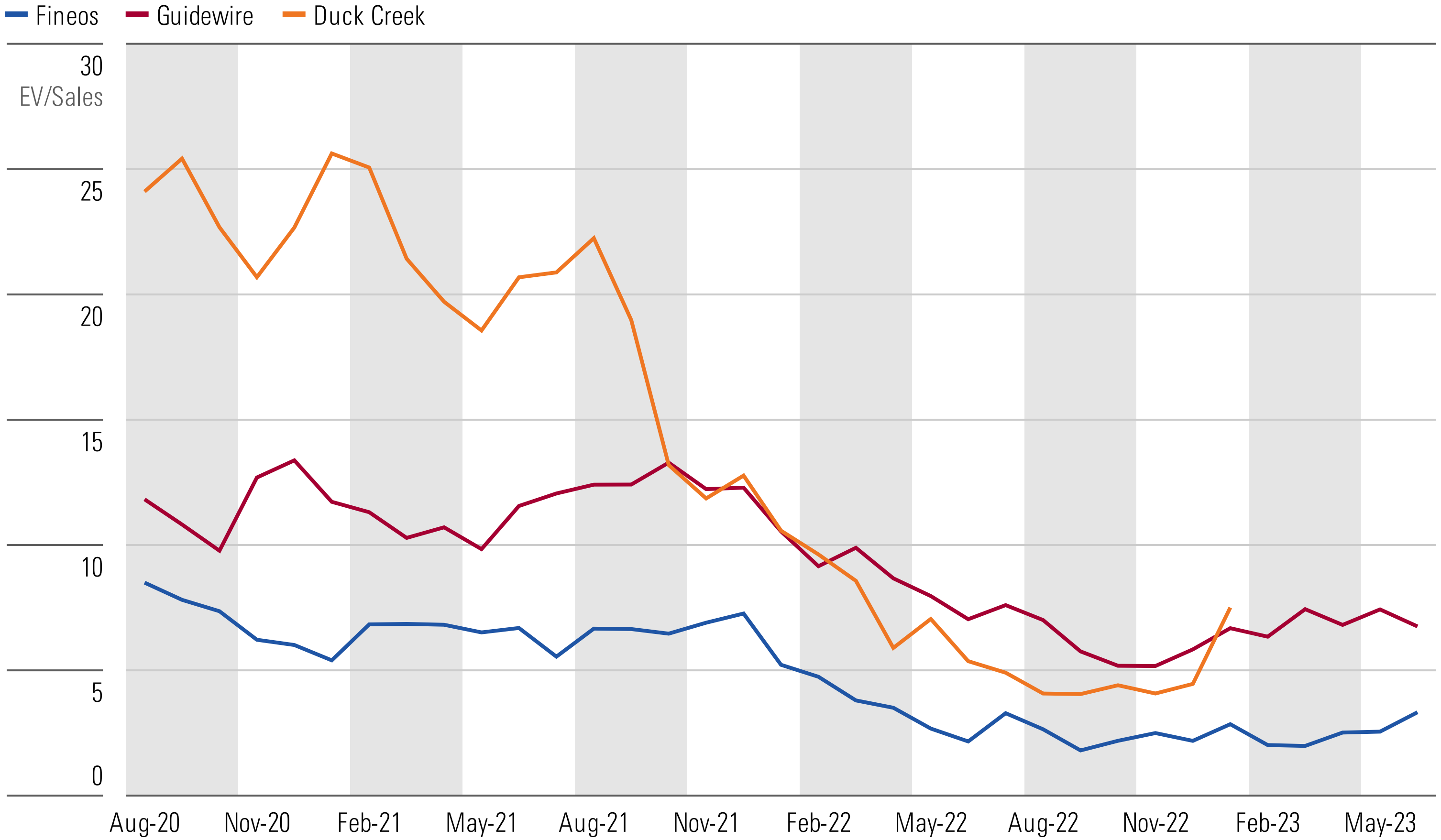


Source: Morningstar, Company Filings. Data as of May 31, 2023.

Risk/Reward Proposition Attractive

Shares Look Cheap Versus Peers

Enterprise value/sales for Fineos and peers



Source: Morningstar, Company Filings. Data as of June 30, 2023.

Multiple at Discount to Peers

Fineos shares trade more than 60% below the long-term peer average for enterprise value/sales. We think this gap should narrow given:

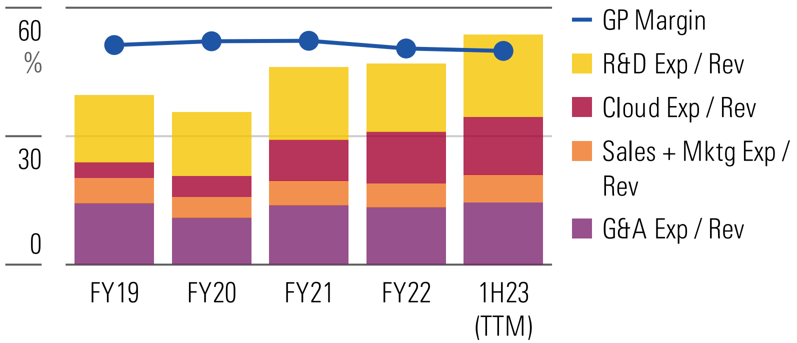
- All three companies face similar tailwinds of digitalisation, regulation, and growing customer needs.
- We think Fineos' proportion of software revenue will grow to match that of Guidewire and Duck Creek.
- Guidewire and Duck Creek's focus on property and casualty insurance customers means we expect Fineos to face limited competition.
- Fineos life insurance customers have been slow to switch. But switching is likely as the software matures and Fineos should then benefit from those high switching costs.

Market Concerns

Margins yet to improve.

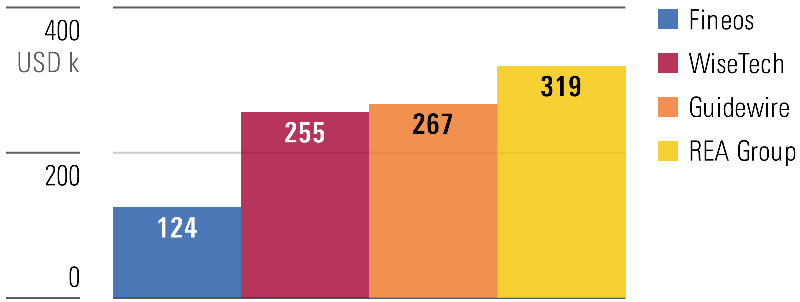
Margin Expansion and Revenue Growth Doubted

Market Doubts Fineos Can Scale Expenses



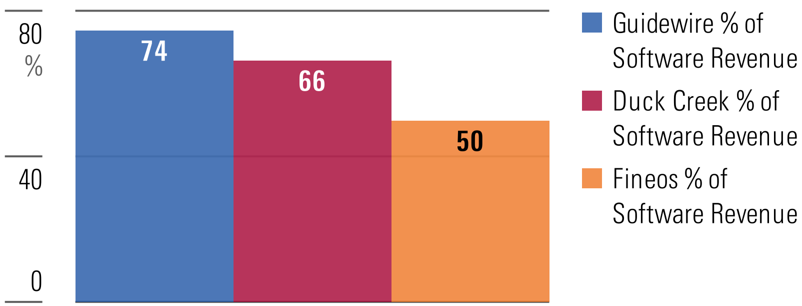
Source: Morningstar, Company Filings. Data as of Dec. 31, 2022.

Revenue per Employee Lags Peers



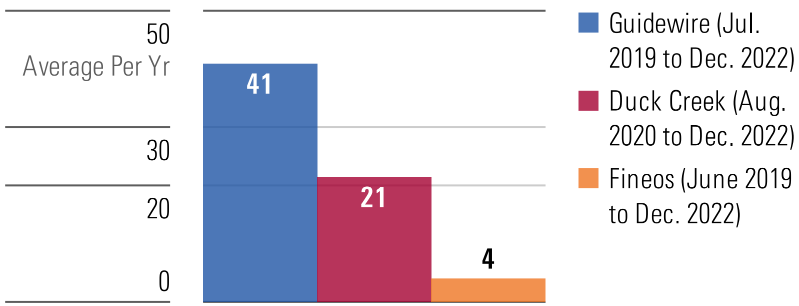
Source: Morningstar, Company Filings. Data as of Jan. 31, 2023.

Subscription Revenue Below Peers



Source: Morningstar, Company Filings. Data as of Jan. 31, 2023.

Client Wins Slow



Source: Morningstar, Company Filings. Data as of Dec. 31, 2022.

Lack of margin growth has investors concerned. Cloud expenses were expected to scale with revenue growth but have grown with customer activity. Technology sector wage inflation further impedes profitability.

Half of Fineos' revenue is from services like product implementation, rather than subscription fees for software. Services revenue is lumpier and lower-margin than software revenue, limiting operating leverage.

Given Fineos' slow customer acquisition rate, the market is wary that larger clients might leverage their bargaining power to resist fee increases or threaten to switch to a competitor, posing a threat to the firm.

Margin Improvement

Important advances underway.

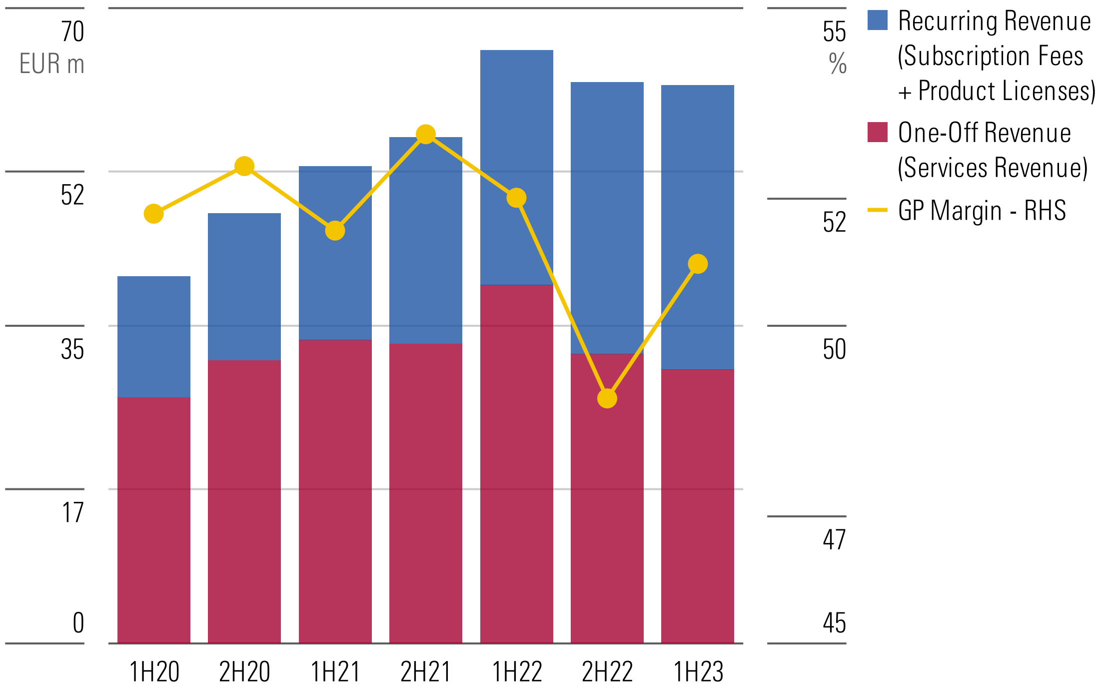
MARGIN IMPROVEMENT

Favourable Mix Shift To Benefit Margins

Customer migration to the cloud requires initial development costs but should yield significant long-term benefits. It allows for recurring subscription fees and the scalable rollout of new client features and support. This is superior to one-off product licence fees. Using the cloud lowers the cost to service clients while relatively fixed operating expenses, like cloud usage, should scale with client usage to expand margins. While profitability is being obscured by initial development costs, such as for product consulting and client transitions to the cloud, they are foundational investments to build scale that were similarly made by other mature software companies in their early stages.

Cloud Transitions To Improve Margins Over Long Term

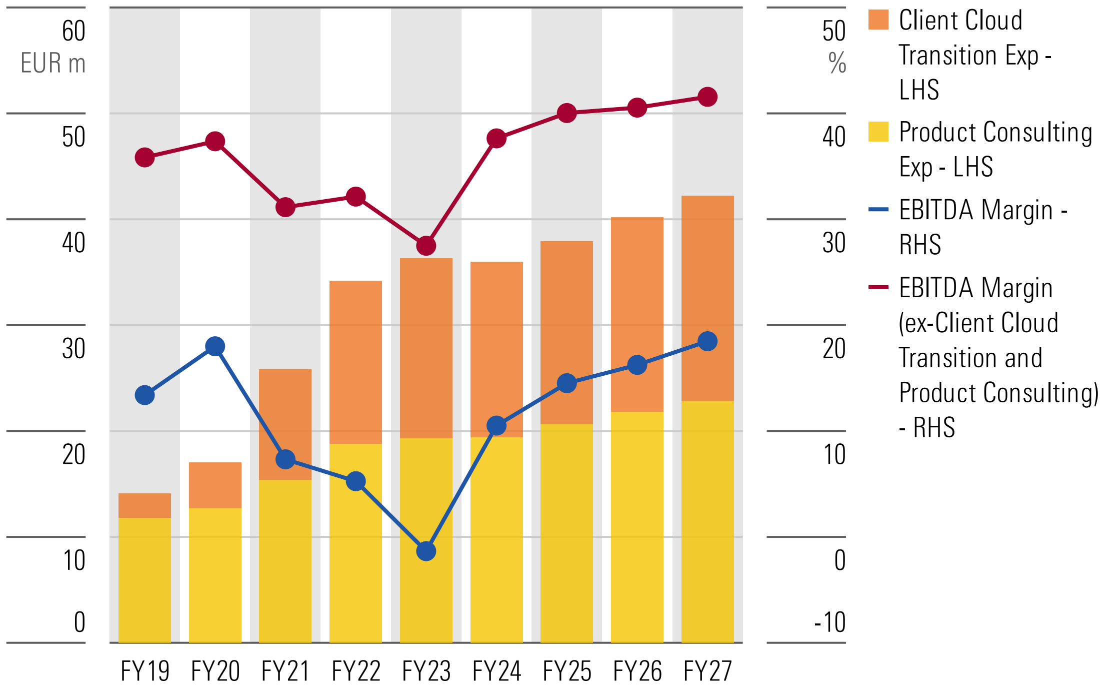
Split of revenue components



Source: Morningstar, Company Filings. Data as of Dec. 31, 2022.

Foundational Costs Dampen Near-Term Profits but Support Long-Term Margins

Fineos' expense items and EBITDA margins



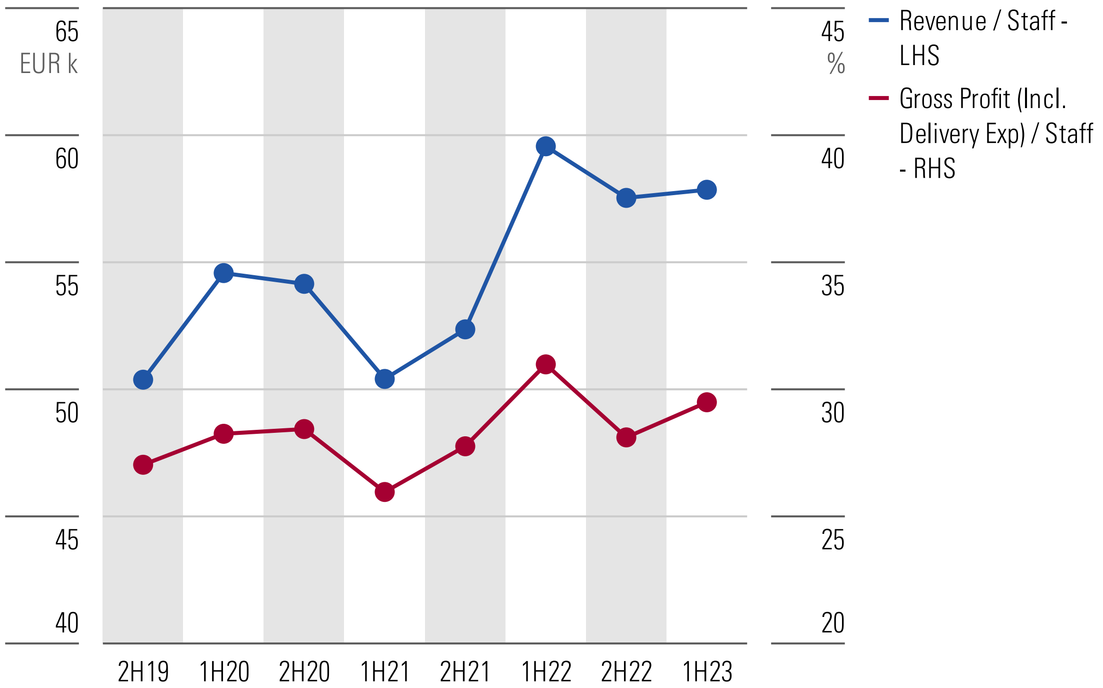
Source: Morningstar, Company Filings. Data as of May 31, 2023.

Cost Reductions and Scale Economies To Help

We anticipate a gradual reduction in headcount, which notably includes external consulting. As Fineos and its software matures, we expect the need for, and the significant expenditure on external consultants to materially decline. Elsewhere, cloud costs should scale with revenue growth as Fineos more efficiently uses third-party cloud capacity. We also expect greater administrative cost-efficiency with scale.

Employee Productivity Improving

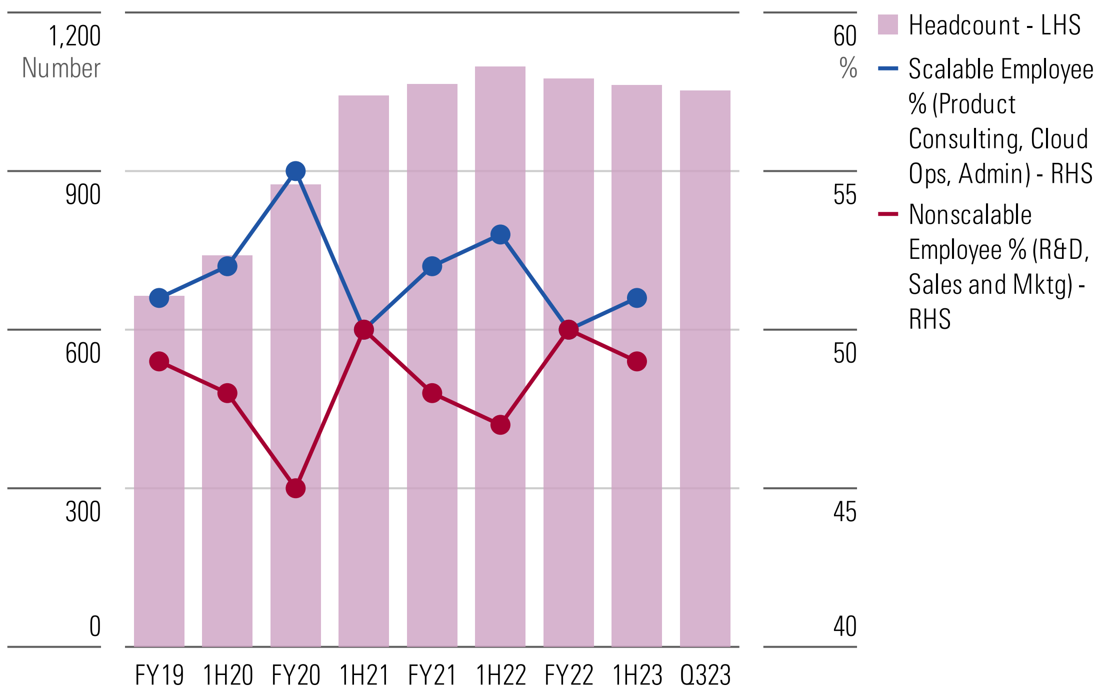
Employee productivity metrics



Source: Morningstar, Company Filings. Data as of Dec. 31, 2022.

Headcount Reductions to Benefit

Employee numbers and proportions



Source: Morningstar, Company Filings. Data as of May 31, 2023.

Revenue Upside

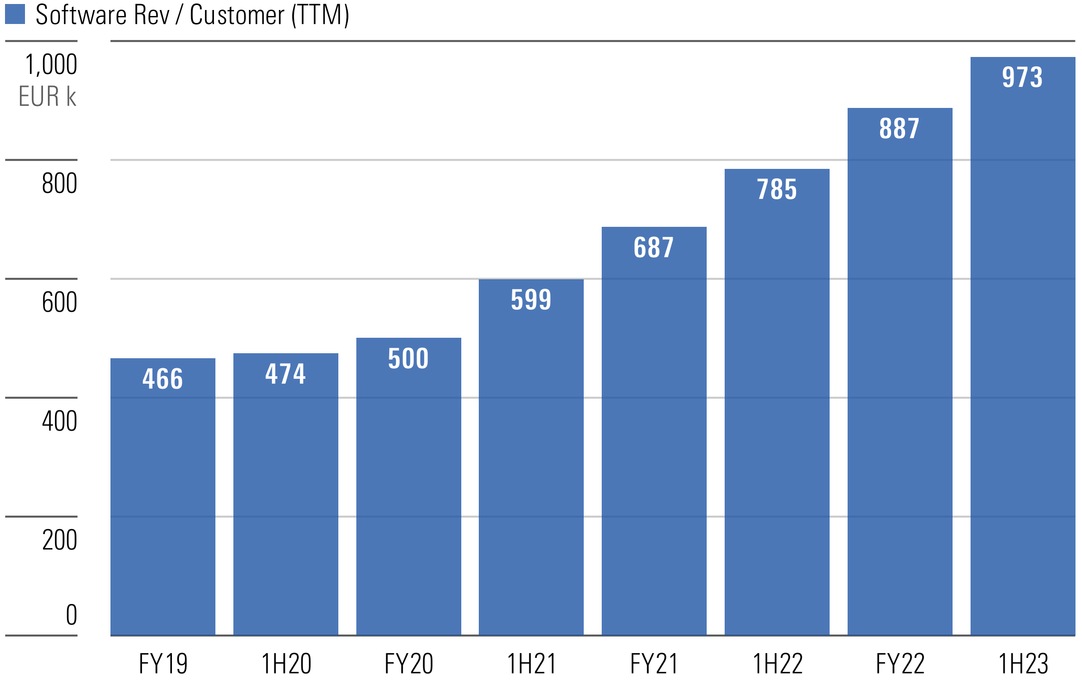
Customer advocacy and cross-selling to grow revenue.

Growing Wallet Share To Expand Recurring Revenue

Improving average software revenue per customer shows Fineos can capture a larger portion of its customers' wallets. This is driven primarily by upselling and cross-selling, which also strengthens customer switching costs. Contracts are indexed for inflation, but the new fees indexed to gross written premiums allow Fineos to grow as insurers tend to raise premiums faster than inflation. This supports recurring revenue growth.

Customers See Value and Pay More

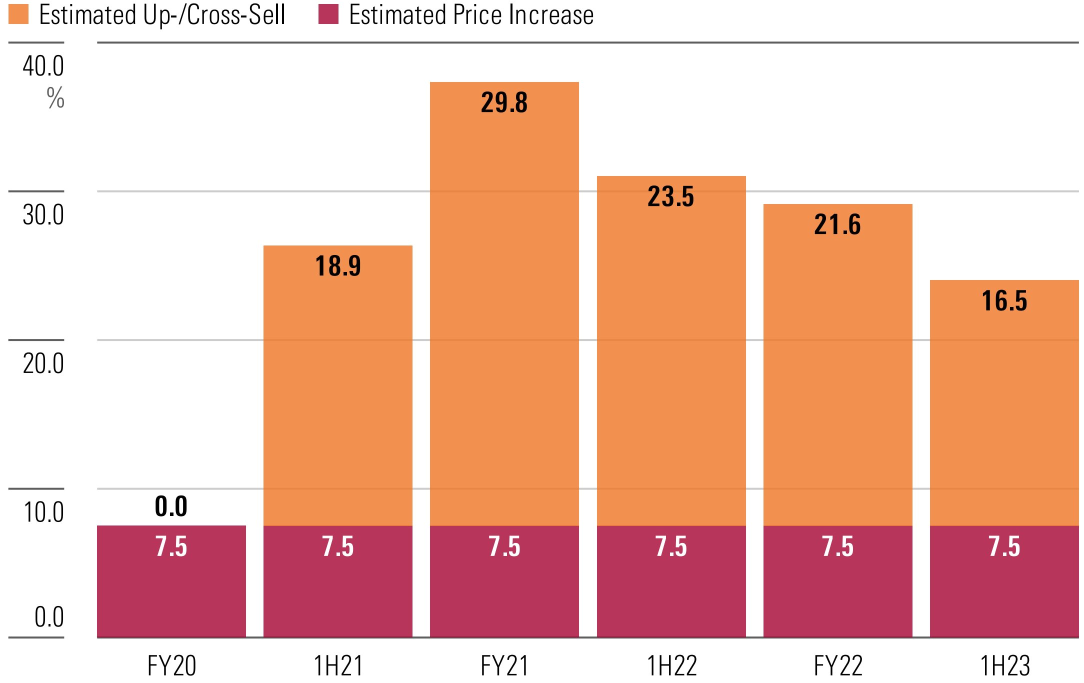
Fineos' average revenue per customer



Source: Company Filings. Data as of Dec. 31, 2022.

Up- and Cross-Selling Powers Growth

Average revenue per customer growth split



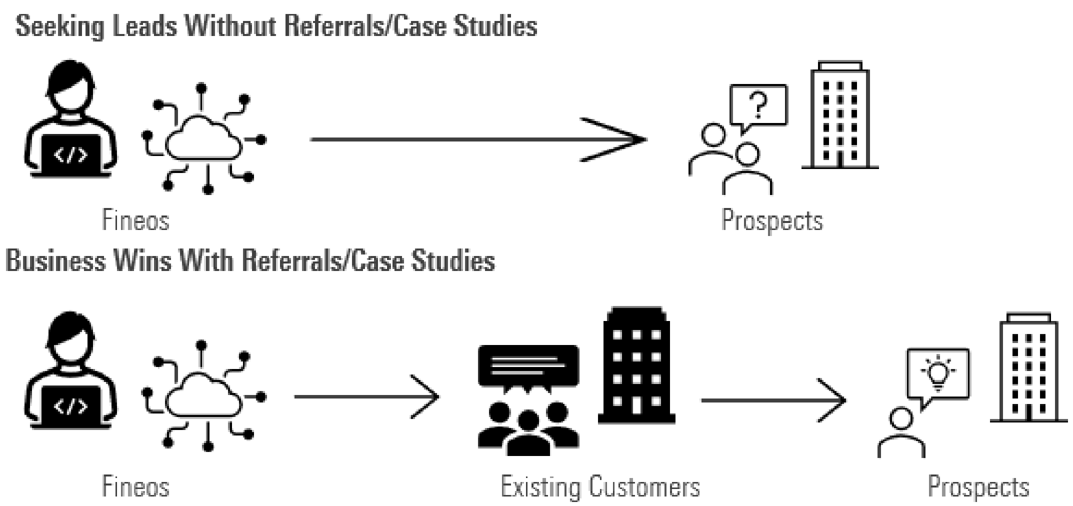
Source: Morningstar. Data as of Dec. 31, 2022.

Customer Advocacy Supports New Business Wins

Fineos has prioritised up/cross-selling to existing customers and compiling successful project implementation case studies over new customer wins. This is sound given switching cost challenges for new insurers. Leveraging satisfied customers enhances Fineos' credibility and reputation among potential new customers. We believe case study growth—showcasing value to insurers—positions the company to attract new customers.

Customer Endorsements Help Overcome Switching Costs

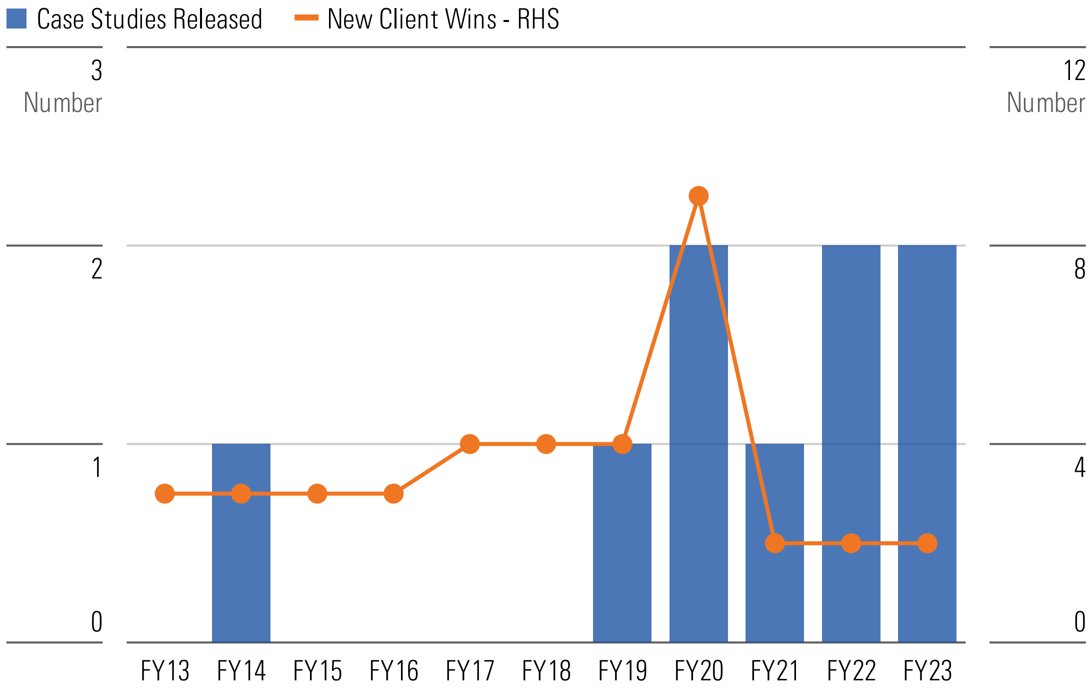
Mechanics of insurance software business development



Source: Morningstar. Data as of May 31, 2023.

Case Studies Should Support Client Wins

Newly-released case studies from existing clients versus new client wins



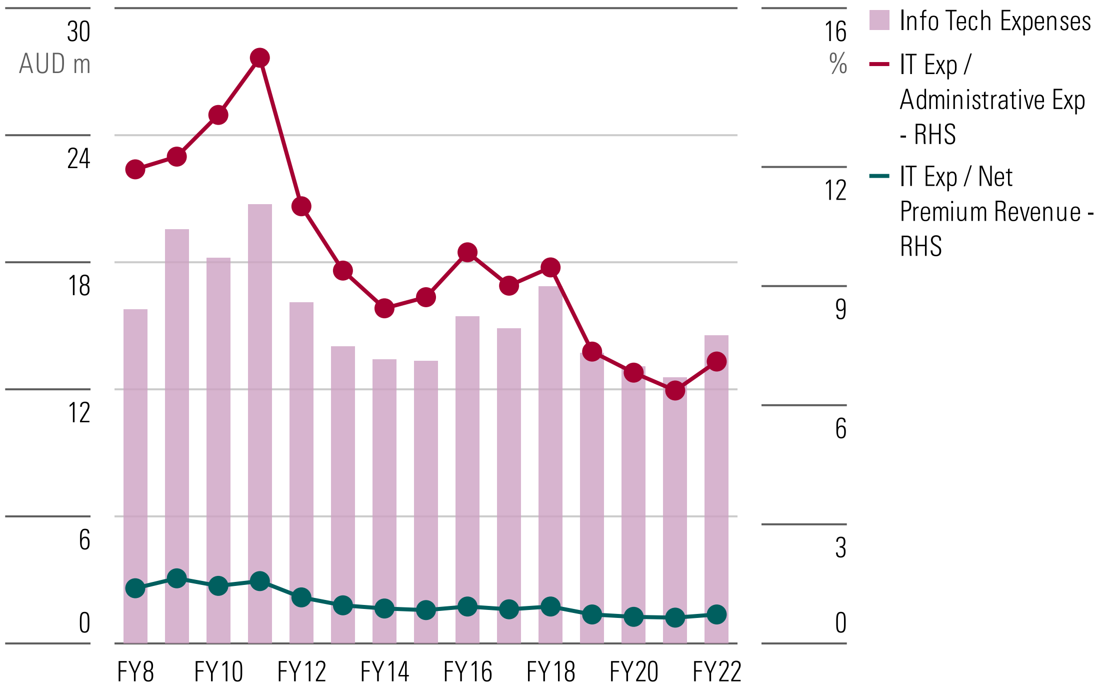
Source: Morningstar. Data as of May 31, 2023.

Customers Digitising Supports Revenue Growth

Growing digital, customer self-service, regulation, and business technology needs support the transition to Fineos' software. We believe the market undervalues this revenue opportunity. The case study below on Transport Accident Commission evidences a notable reduction in costs relative to premiums through utilising Fineos' software. As Fineos continues to integrate its platform into client workflows, we anticipate substantial revenue growth in tandem with its insurer clients. Furthermore, considering the Fineos platform's small overall cost to insurers, particularly when compared with other major expenses like claims, we are optimistic in Fineos' ability to keep increasing product fees in the future.

Fineos Helps Clients To Save Costs and Increase Revenue

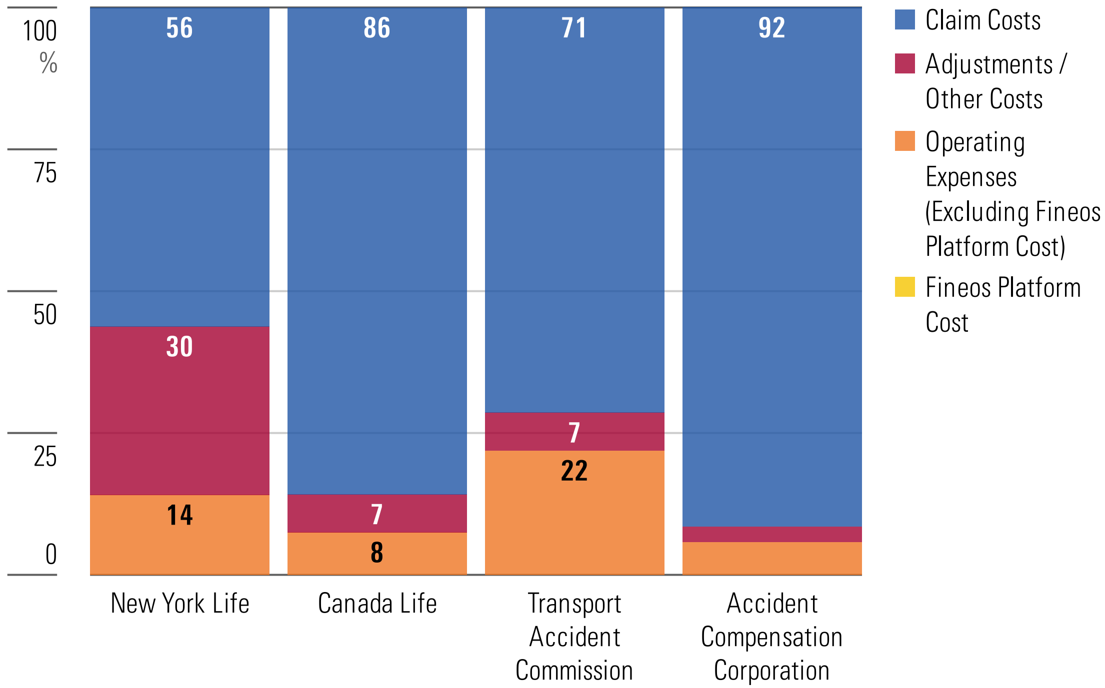
Transport Accident Commission case study



Source: Morningstar, Company Filings. Data as of June 30, 2022.

Small Overall Cost to Clients Bodes Well for Pricing Power

Estimated Fineos platform cost as a proportion of client total expenses.



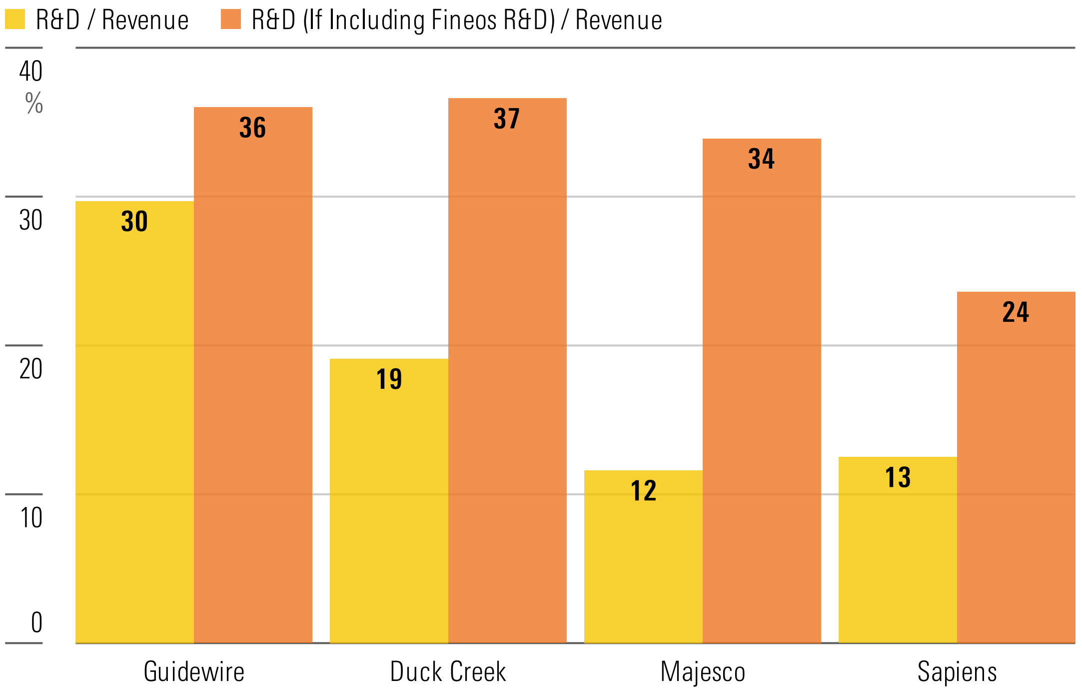
Source: Morningstar, Company Filings. Data as of Dec. 31, 2022.

Competition Likely Limited

We think large life, accident, and health insurance carriers are likely to stay with Fineos. We also think peers, who mostly operate in property and casualty, are likely to focus on their own niches. For a prospective competitor, the payback period from entering Fineos' end insurance market is very long given Fineos is already established, upfront software development time and costs are significant, and the current profit pool is small. We also think investor desire to finance loss-making startups in this area is limited, which importantly gives Fineos more time to gain market share and strengthen customer switching costs.

Prohibitive Investment Costs to Discourage New Entrants

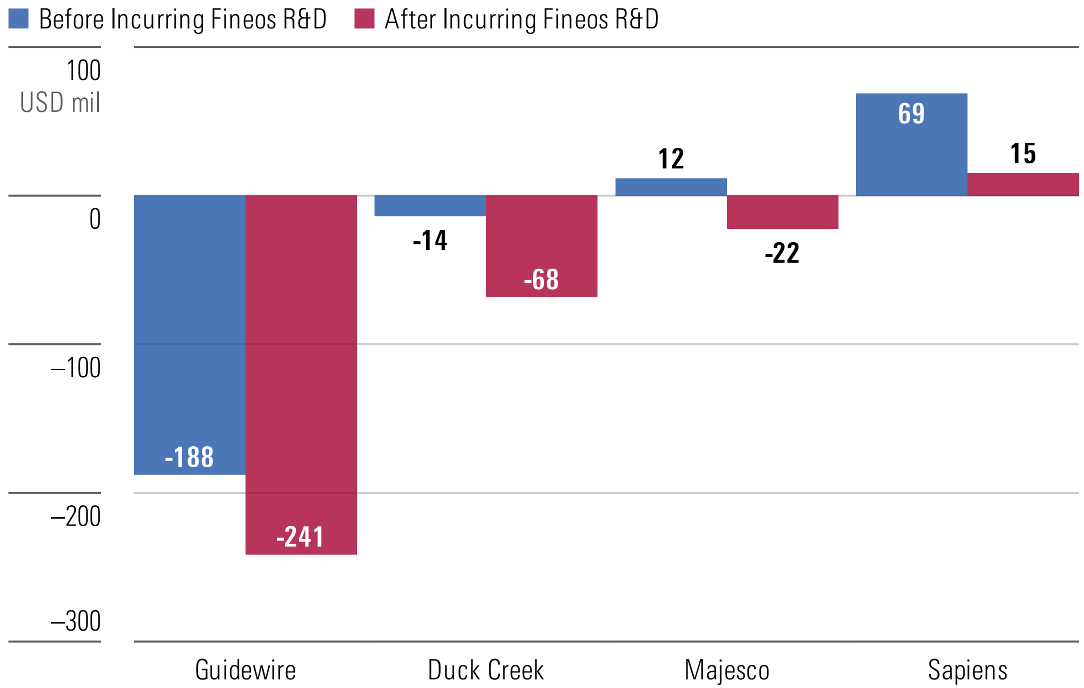
Peer research and development spending as proportion of total revenue*



Source: Morningstar, Company Filings. Data as of March 31, 2023.
* Orange bars show if competitors were to assume Fineos' additional R&D expense to enter Fineos' market.

Small Profit Pool Likely to Limit Competition

Competitors' annual operating earnings (EBIT)*



Source: Morningstar, Company Filings. Data as of March 31, 2023.
* Red bars show the adverse impact on competitors' earnings if they were to incur Fineos' R&D expense.

Valuation

Materially undervalued despite improving outlook.

Shares Offer Compelling Value

Margin Improvement To Restore Confidence

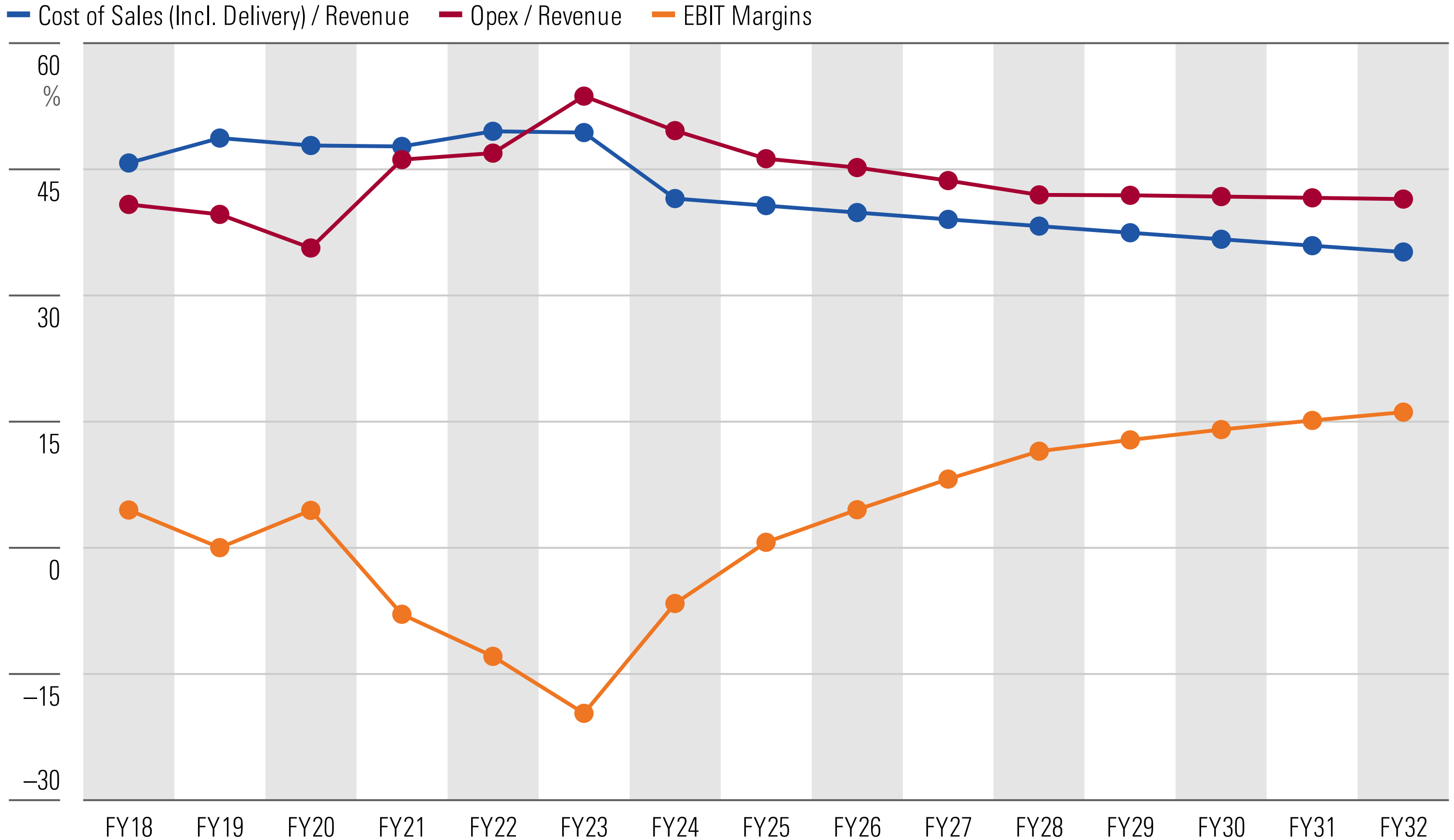
The lack of profitability provides an opportunity for investors. We see positive free cash flows from 2024 and further margin improvement supporting a share price rerating.

Key Valuation Assumptions

- Fair value estimate of AUD 3.30 per share
- Operating margins of 16% by fiscal 2032 (negative in fiscal 2022)
- Gross profit margins including delivery expenses of 65% by fiscal 2032 (51% in fiscal 2022)
- Maintainable, positive net profits and free cash flows starting fiscal 2025
- Market share growth to 2.3% of insurer software spending pool in fiscal 2032 (1.3% in fiscal 2022)
- Software revenue growing to 73% of group revenue by fiscal 2032 (44% in fiscal 2022)
- No large-scale acquisitions over our forecast period

Share Price Re-Rating Likely If Margins Grow

Financial Performance Metrics



Source: Morningstar, Company Filings. Data as of May 31, 2023.

Thesis Validation

We Expect Fineos To Deliver Margin Improvements With Haste—as Soon as in Fiscal 2024—To Restore Confidence in Its Growth Story

Metric	Bear Case (AUD 1.60)	Base Case (AUD 3.30)	Milestones
Expenses	• Relatively flat annual operating expense growth • Cloud and administrative costs scale at a much slower pace	• 6% average annual operating expense growth • Scalability mainly in cloud and administrative expenses	• Gradual headcount reductions from first half fiscal 2022 levels • Ongoing growth in staff productivity, for example revenue or gross profit per staff • Margin improvements from fiscal 2024 onward
Revenue	• Low-single-digit revenue growth - No new customer wins	• 8% average annual revenue growth • Software revenue more than 70% of revenue by fiscal 2032	• Ongoing growth in average revenue per customer, coupled with new client wins from fiscal 2024 onward • Growth in software revenue in excess of 10% per year, outstripping growth in services revenue
Cash Flows	• First full year of positive free cash flows in fiscal 2026 - A year behind target	• First full year of positive free cash flows in fiscal 2025	• Material reduction in negative free cash flows by the first half of fiscal 2024, positive free cash flows in second half of fiscal 2024 • No debt drawdowns

Source: Morningstar. Data as of June 30, 2023.

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