THE ANALYST

Burford Capital: Supersized Returns Look Difficult to Maintain
SHORT @ £16.86

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Burford Capital – View All Notes and Models

Recommendation: **Short (Initiation of Coverage)**

Price: **£16.86**	2-Year Price Target: **£12.75**	Forecast Return: **24%**
3m Average Daily Volume: **$10.9m**	Market Cap: **£3.5bn**	Ticker: **BUR LN**
Valuation Metric: **Sum of the Parts**		

Investment Thesis

- **Burford Capital has been a pioneer in the fast-growing litigation finance market but competition is accelerating and we see the seriously impressive 75% ROIC on cases to date falling to 30% in the medium term.**
- **The company trades at 4x book value for what is essentially an investment fund – this appears excessive.**
- **The Petersen claim represents ~20% of group EV, yet there is potential for the claim to fail due to corruption allegations in Argentina.**
- **Corporate governance is not ideal; CEO and CFO are married and two founders sold ~33% of their stakes in 2018.**
- **Our sum-of-the-parts valuation of $3.6bn (£2.8bn) gives 24% downside to our £12.75 price target.**

Excessive Valuation

Burford Capital has been a top performer on the UK AIM market over recent years, rising from an £80m IPO in 2009 to a £3.5bn market cap company today. This for a business with ~100 employees — a very impressive £35m of market cap per employee.

The company is a pioneer in the litigation finance market and continues to lead the sector. However, whilst performance has been impressive, the valuation has got seriously ahead of itself and the company is priced at ~4x book value, which we see as excessive, and investors are making the mistake of valuing it on a PE ratio (currently 18x FY'18e) despite returns being highly volatile and dependent on one-off cases. Investors previously made a similar error with Arrow Global, which also reached over 4x book value but is now sub 2x book value following scrutiny of the business model.

We also see increasing levels of capital entering the industry from competitors and expect the impressive ROIC of 75% on cases seen to date will likely fall in the future to (a still impressive) ~30%. Returns have also been highly skewed by the Petersen and Teinver cases relating to Argentina. We value the remaining Petersen claim at $800m, nearly 25% of our $3.6bn EV valuation. However, there are doubts that the Petersen case will actually be won, which would reduce Burford's valuation further, well below our current price target.

We value Burford at £12.75, implying 24% downside. We therefore initiate on Burford with a short recommendation.

Burford Capital Is the Early Mover… But Competition Is Increasing

Burford was the first significant player in the relatively new litigation financing industry. Lawyers traditionally have operated as partnerships and do not have the capital or desire to fund their own clients' cases. Additionally, the length and complexity of many cases is often unsustainable for companies to pursue given that they need to expense their legal fees through the P&L statement with only the potential of a one-off recovery years in the future. Banks have not expanded into litigation finance given the risk of conflict when financing a legal case that may involve one of the bank's customers. Burford was the amongst the first to recognise a significant gap in the market by providing capital for litigation to be seen through to conclusion and for the plaintiffs to receive proceeds more quickly.

The size of the addressable market in litigation finance is difficult to define, although we do know that globally it represents only a tiny fraction of total spending on legal costs. Usage in the US is growing, up from 7% of US law firms in 2013 to 36% in

2017, but this still leaves further room for growth. Vannin sees the litigation spend in the UK, Australia, and the US at ~$20bn, with third-party funding at ~1-3% of that. Another estimate from a legal analyst at Whitebox Advisors is a market of $50-100bn based on the billings of the largest law firms.

Burford is by far the largest operator in the industry, with ~$1.1bn of on-balance-sheet litigation investments (plus $0.7bn of further commitments) and another ~$1.5bn in off-balance-sheet investment funds. The segment is becoming popular with investors due to its high returns and lack of correlation with other assets (such as property or bonds). However, competition is increasing and significant levels of capital are entering the industry. Exhibit 1 summarises some of these competitors.

Exhibit 1: Litigation Finance Industry Competitors

Competitors	Founding Date	Funds available	Notes
UK:			
Vannin	2010	~$500m	Was planning £70m IPO on AIM, delayed due to weak market conditions
Harbour Litigation Funding	2007	£760m	Four funds, funded over £5.4bn of legal claims. Staff from Magic Circle law firms. Asset base doubled in last 12 months alone.
Therium	2009	>$800m	Funded $36bn of claims.Has Europe and USA assets. Announced plan to launch full Australia service in 2019.
Calunius Capital	2011	>£200m	
Woodsford Litigation	2010	n/a	Opened US office in 2017 and plan to open an APAC office
Augusta Ventures	2014	>£250m	Started in London, opened Sydney office in 2017. Committed £98m to funding 162 cases. Raised another £150m funding in July 2018. 57 staff
Chancery Capital	2017		Founded by former Managing Director of Burford
Benchwalk	2018		
US:			
Longford Capital	2014	>$500m	Raised $500m fund in September 2017 and have spent over 2/3 of this.
Pravati Capital	2006	a few hundred $m	
Parabellum Capital	2006	$300m	Investments in single cases up to 8 figures. Founder warning that industry is at risk of becoming commoditised.
Lake Whillans	2015	$150m	$50m from University of Michigan
LexShares	2014	n/a	Crowdfunding approach, investors can put in >$2,500 into individual cases or a portfolio of legal casess.
Mighty	2018	$105m	New York City start up
Validity	2015	£250m	Started by former head of IMF Bentham's US operations
Virage Capital	2013	$665m	Hedge fund
EJF Capital	2018	$300m	$6bn hedge fund, raising $300m investment vehicle to invest in mass-tort cases.

Source: Company Websites, Accessed November 2018

There is also Australian-listed IMF Bentham, the second largest litigation finance provider globally, with A$2.2bn of funds available and A$667m of claims funded.

Two more litigation funds are expected to launch by the end of the year. In the past 18 months, ~30 new funds have been launched and >$2bn of investment capital raised. Barriers to entry in the industry are clearly falling and interest in the litigation finance sector is higher than ever thanks to its currently superior returns and lack of correlation with other investable asset classes. Legal expertise is noted by Burford as a key barrier to success; however, with a number of Burford's own staff leaving to set up their own firms and other firms being set up, this advantage is declining.

Howard Shams of Parabellum noted in September 2018 in an interview with The American Lawyer that the industry risks commoditisation and he is readying the firm for this prospect, following massive fund raisings in the US. Since early 2017, at least eight entities have raised >$100m to invest in litigation, compared to only three such capital raises in the three previous years combined. Shams notes that funders will eventually start competing with one another on price in the profitable cases, which would mean that the very high returns (3-6x returns on investment) will shrink. That is not happening yet but will happen in due course.

Overall, we see competition increasing as the industry starts to mature. Burford remains the largest provider and retains the advantages of experience in the industry plus being the most recognised name in the sector and having the largest capital base; however, in time, we see that this will no longer be enough to retain the 75% ROIC on cases completed in future.

Returns Look Impressive… But Can This Continue?

Competition is one reason for our expectation that returns will fall, but we also consider the one-off nature of cases and the way that Burford accounts for them.

- Burford's accounting of cases uses IFRS 9, which allows revaluation of ongoing cases to their market value each year and the gain or loss in the value of the case to be posted to the income statement as litigation income. This forms a key part of returns, with $424m out of $860m total investment returns since FY'12 coming from these revaluations as compared to realised gains as cases settle. Burford is correct in using this accounting treatment; however, it does mean that around half of the returns are only paper returns rather than cash through the door.

- Burford's 75% ROIC on completed or partially completed cases up to FY'17 is extremely impressive, with $772m recovered on $443m of investment. We highlight below some of the disclosed cases for which Burford has secured excellent returns – these are quoted from Burford's annual reports:

    1. FY'12: An innovative, technology-based competitor developed a new solution that was promptly squashed by the dominant market player. Burford's financing permitted high-quality antitrust counsel to represent the smaller firm, which would not have been economically possible otherwise, and the case settled less than a year after Burford's involvement. Burford received $5.2m on its $3m investment – an IRR of more than 150%.
    2. FY'12: Burford financed a smaller technology company in a heated dispute with a much larger firm. This was a successful investment for Burford. Burford received $6.5m in gross proceeds on its $4.9m investment, a net profit of $1.6m in 14 months and an IRR of 37%.
    3. FY'12: Burford invested $1.4m in a patent dispute. Burford almost doubled its money, with a $1.1m net profit on the investment after 15 months.
    4. FY'14: A small matter concluded rapidly, with an investment of only $0.2m producing a gross recovery of $0.9m in well less than a year, for a 271% return on invested capital.
    5. FY'14: Rurelec PLC (concerned the Bolivian government's decision to nationalise Rurelec's controlling stake in a Bolivian power company in 2014). Cost: Burford contributed $15m; claim was $31.5m; Burford received $26m award.
    6. FY'15: Burford's largest investment success ever, a $61m recovery on a $25m investment.
    7. FY'15: A portfolio investment made in 2011 continued to produce profits, with total recoveries rising to $42.5m (2014: $26.1m), a 325% return on invested capital.
    8. FY'16: Burford tested the market by making one commercial portfolio investment which resolved fairly quickly; earning $1.1m in profit, a 40% IRR.
    9. FY'17: Burford's client was a business that rehabilitated moribund oil fields in an effort to increase production. It was typically compensated for doing so with a small fee and a share of the additional production its efforts generated. Having achieved success across multiple fields, the oil field owner purported to terminate the contract and avoid liability for the success payments to the client. The client brought a commercial arbitration proceeding to enforce the contract and to obtain payment of its success fees. Burford agreed to finance up to $4.7m for the pursuit of the claim.

Unusually, the case did not settle and proceeded to adjudication. The arbitration tribunal found unanimously in the client's favour, upheld the contract, and awarded damages. Under its agreement, Burford was entitled to its invested capital back on a first dollar basis, a preferred return of 2.8x of invested capital, and a portion of the net damages based on a formula. Ultimately, Burford received $16m in proceeds, for a profit of $11.3m on its $4.7m investment, generating a 112% IRR and a 240% ROIC.

- However, these examples sit within the 76 cases that have either concluded or partially concluded. Another 67 cases remain ongoing, with $370m of invested capital in these cases. Of the 77 cases invested in from IPO up to FY'14, 19 remain ongoing and another seven have only partially concluded. An impressive $435m has been recovered on $297m of investments; however, $73m remains invested in ongoing cases and these are now more than three years old. Some of these cases will likely eventually conclude but **we fear that a number of them will not. If we look at the FY'09, FY'10, and FY'11 cohorts, then we see that the number of concluded cases has stabilised at around 75% of the total.** We know little detail on the majority of the cases due to their confidential nature and so cannot make any judgement of the success potential of these cases, but we do see it as worrying that around 33% of them have yet to conclude after three years of litigation.

Exhibit 2: Burford's Concluded Cases by Year of Investment up to 2014

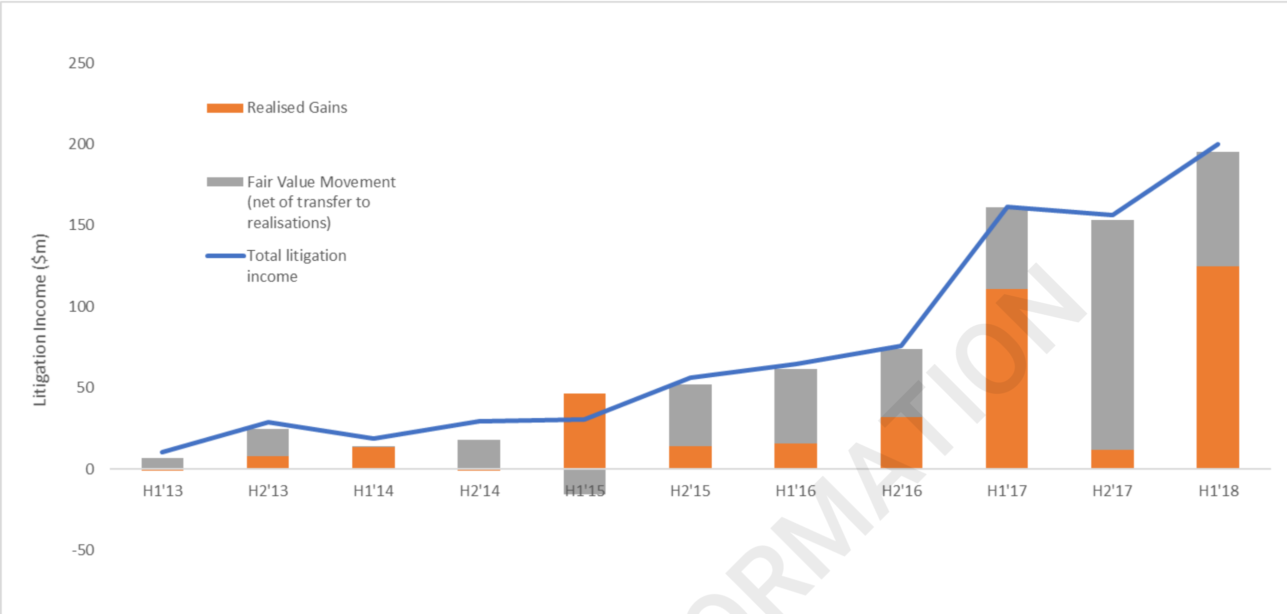
Year of Investment	Cases Concluded - Cumulative				
2009	**FY'13**	**FY'14**	**FY'15**	**FY'16**	**FY'17**
# of investments	3	3	3	3	3
Concluded	*3*	*3*	*3*	*3*	*3*
2010	**FY'13**	**FY'14**	**FY'15**	**FY'16**	**FY'17**
# of investments	16	16	16	16	16
Of which concluded	*9*	*10*	*10*	*11*	*12*
2011					
# of investments	14	14	14	14	14
Of which concluded	*6*	*7*	*8*	*8*	*9*
2012					
# of investments	9	9	9	9	9
Of which concluded	*4*	*5*	*7*	*8*	*8*
2013					
# of investments	12	12	12	12	12
Of which concluded	*0*	*6*	*8*	*8*	*8*
2014					
# of investments		23	23	23	23
Of which concluded		*1*	*6*	*8*	*11*

Source: Burford Capital Annual Reports, Accessed November 2018

- 75% ROIC only applies to completed or partially realised cases, many of which originate from before 2015 when competition from other providers was more limited. In addition, those returns are heavily skewed by the single Petersen case (explained in more detail later), in which $106m was recovered in FY'17. Otherwise, ROIC on completed or partially realised cases would actually have fallen from 60% in FY'16 to 45% in FY'17. We expect capital invested from 2016 onwards will not be able to generate the same level of returns as these cases settle in the next few years due to the increased competition from other providers and difficulty in finding another case with Petersen-like returns.

- Burford's litigation income has grown remarkably smoothly over the last five years, a feature that has made the company highly attractive to shareholders. However, by its nature, this is a business where we would expect much more volatile returns. Breaking the income down into realised and non-realised gains shows how volatile returns can be. These smooth growing returns can encourage investors to value Burford on price to sales or price to earnings ratio, both of which are completely spurious valuation metrics for Burford.

Exhibit 3: Burford's Litigation Income Split



Source: Burford Full-Year and Half-Year Results, Accessed November 2018

Overall, we emphasise that litigation finance is a highly volatile business and Burford's valuation at 4x book value assumes that the remarkably steady high returns seen in recent years will likely be sustained in future. In reality, returns are highly volatile and we are concerned that the growing bank of older cases yet to be realised will not also generate a 75% ROIC on completion. In the medium term, we expect Burford's ROIC to fall to (a still very impressive) 30%.

The Petersen Case

Burford's biggest asset on its balance sheet is the Petersen claim. Burford sold 10% of its interest in early 2017 for $40m, a further 15% interest for $66m in 2017, and another 3.75% for $30m in July 2018. Burford still holds the remaining 71.25% of the claim, with the recent tranche sale implying a $570m valuation (which represents over 10% of Burford's market cap). Firstly, we note the background of the case:

- YPF is an Argentinian oil company that was privatised in 1993, with the majority acquired by Repsol. Later, the Argentinian government under President Nestor Kirchner wanted part of the business to have an Argentinian owner. Argentinian businessman Enrique Eskenazi owned various construction assets through his company, Petersen, and decided to build up a stake in YPF.

- Over the period 2008 to 2011, Eskenazi built up a 25% stake for $3.4bn, almost entirely with borrowed money, some bought from Repsol and the rest from banks. Eskenazi was on the YPF Board of Directors but had no prior experience of the oil sector.

- YPF's dividend payments increased after the Eskenazi stake was taken. Petersen used the dividend payments to cover the interest payments on the debt.

- The arrangement worked well as long as the dividends were paid. However, Nestor Kirchner died and his wife Cristina Kirchner became President. Argentina also became a net importer of energy due to a lack of investment and the sector attracted political scrutiny.

- YPF was then renationalised in 2012, with the Repsol stake expropriated. Repsol sued Argentina and received ~$5bn in damages. The Petersen stake was not expropriated; however, the YPF dividends stopped. Petersen then defaulted on its debts, with the shares sold to meet repayments.

- A receiver was appointed in Spain and they commenced proceedings against Argentina. The claim was sold to Burford for ~$18m, with an obligation to repay 30% of any returns to the lender group. Burford continues to fund the lawsuit, with the total claim for >$3bn.

- The Petersen claims have been made in the US courts, although the Argentinian government wants the case held in Argentina. On 10 July 2018, the US Second Circuit Court of Appeals affirmed the original trial court decision that the case should be heard in the US federal courts. The case may be appealed again by Argentina at the Supreme Court; otherwise, it now returns to the trial court for substantive proceedings.

Burford's 71.25% stake has an implied ~$570m valuation based on Burford's last sale of 3.75% of it — this compares to an $18m initial investment. The investment has generated superb returns for investors so far given that Burford has already generated $136m of realisations plus considerable unrealised gains. However, there are allegations within the Argentinian press (mainly the Clarin newspaper) that the YPF shares were acquired by Petersen through corrupt means. If proven, the whole Petersen case could be thrown out.

- Before becoming President, Nestor Kirchner was governor of Santa Cruz province from 1991 to 2003. When YPF was privatised, Santa Cruz was paid $654m in outstanding royalties. There are numerous corruption allegations surrounding these funds, which passed through various offshore accounts. While Kircher was governor, Eskenazi took control of the local Banco de Santa Cruz, which was apparently used to embezzle funds. It appears likely the funds were used to fund Nestor Kirchner's 2003 election campaign and Cristina Kirchner's 2007 election campaign.

- Early in 2017, financier Aldo Ducler, who was tasked with handling the Santa Cruz funds, presented a letter to the Financial Information Unit (FIU) saying he had evidence of corruption by the Kirchners. In return, he would get a reward and privileged legal treatment. Two days later, he died suddenly on a street in Buenos Aires.

- Aldo Ducler's son Juan Manuel Ducler then continued his father's quest to expose the Kirchners' corruption, saying that he had documents that showed the Petersen stake was acquired by corrupt means. However, Juan Manuel Ducler was arrested in September 2017 and was then convicted of trying to extort >$20m from one of the Eskenazi family in order not to pass any evidence to the authorities or the press. He was convicted.

- On 05 September 2018 (after his conviction for extortion), Juan Manuel Ducler passed a copy of the report compiled by his father, noted at 2,168 pages, to Argentinian judge Claudio Bonadio, who is currently investigating corruption allegations against the Kirchner family.

- Other links to the above allegations include:
  - Organización Periodística Independiente, 'With Santa Cruz Funds at Credit Swisse, Eskenazi guaranteed the purchase of YPF'
  - Clarín Politics, 'A millionaire business: The keys to the maneuver to stay with YPF'
  - Noticias & Protagonistas, 'Alejandro Sánchez Kalbermatten: 'Among the repentant Eskenazi missing''

If corruption allegations were ever proven and the Petersen case thrown out, then the potential ~$3bn of final proceeds would of course be wiped out and any unrealised gains recognised in Burford's income statement would need to be written back down to zero.

Also, we note that since Repsol received its $5.5bn of damages, the Argentina peso has lost 75% of its value against the US dollar and inflation is running at 45%. The country is also taking IMF loans. Whilst the devaluation does not affect the value of the claim (YPF was listed in US dollars), these economic troubles could affect Argentina's ability to actually pay the claim, which represents ~5-10% of the country's $57bn total bailout package from the IMF. It at the very least increases Argentina's desire to get the whole case thrown out.

We do not ourselves conclude that the corruption allegations are correct, but merely note that there is considerable press activity around the case that investors should be aware of and that the Petersen case is not a certain win, and even if it is won that the funds would actually be paid.

Petersen and Teinver Boost to Recent Returns

As well as doubts around whether the Petersen case will succeed, we note that this case and the Teinver case (which is also in Argentina) have generated huge returns in Burford's income statement over the past two years and have helped generate the remarkably smooth increase in income over that period.

In the 2015 vintage, returns appear impressive, with 183% ROIC and £171m recovered out of £77m investment and only £41m in ongoing investments remaining. However, of the $108m from partial realisations, $106m came from Petersen on an $18m investment.

Petersen's market value today of $800m implies $570m of value for Burford's remaining 71.25% stake. Burford has, however, sold chunks of the stake in recent years, plus there have been upwards revaluations to levels below the secondary market valuation.

We outline the timeline of Burford's investment in Petersen along with the company's commentary after sales:

- 2015: Burford invests $18m into Petersen case.
- 30 December 2016: Burford sells 1% of its interest for $4m at implied $400m valuation for the full interest. Burford notes: '*We did not believe that the sale of a mere 1% of the investment made it appropriate to value the entire investment at that implied value, and we did not do so. We increased the fair value of the Petersen investment to a level substantially less than that implied value in 2016, although it was our largest fair value adjustment'* (FY'16 Annual Report).
- March 2017: Burford sells another 9% of its interest for $36m, again at the implied $400m valuation.
- June 2017: Burford sells another 15% of its interest for $66m, implying a $440m valuation. Also notes Burford will permanently hold at least 50.1% of the original claim through to completion. *'As to Petersen specifically, there are two significant indicia of value: a series of secondary market transactions with sophisticated arm's length investors, and an initial success in the trial court. Thus it seems appropriate to increase Petersen's carrying value from its prior level, and we have done so. We have not however increased the value all the way to the level of the secondary market transactions given the illiquidity (including by contractual provision) of Burford's position'* (H1'17 Annual Report).
- H2'17: Further secondary market activity in 2017 was at an average $660m valuation for the full original Burford interest in Petersen. *'We have thus increased the carrying value of our remaining investment in Petersen. We do not release individual investment carrying values for reasons of client confidentiality and litigation strategy but we can say that we have acted conservatively with respect to Petersen as is our general practice. In the end we altered the carrying value of 15 investments in 2017 and the net increase in value across all of those investments was $181m, so it is clear that we have not increased the carrying value of Petersen to anything approaching its secondary market trading level, which we do not regard as determinative of our own carrying value.'*
- July 2018: Burford sells another 3.75% of its interest for $30m, implying a valuation of $800m for the full original Burford entitlement and $570m for Burford's remaining 71.25% stake. As previously noted, the case also passed through a further positive US court decision. In the statement, Burford said *'We carry our Petersen investment at a lower carrying value than $800m for the reasons we have enunciated previously'.*

Burford says that the claim is held on the balance sheet at a 'conservative' level, well below the $570m secondary market value, but does not give an exact number; therefore, we do not know the level of fair value gains recognised so far in Burford's income statement from the case. Given that the value has been increased in stages, we also do not know the split of that income across the accounting periods from FY'16 to FY'18; however, we do know that the amounts are material.

The Teinver case is smaller but equally material, relating to the expropriation of two Argentine airlines by the Argentine government. Burford invested $12.8m into the case and sold the entitlement to the claim for $107m in H1'18. The claim was partially written up in FY'17 to an amount that we understand to be ~$30m.

Given the potential impact of both claims on the income statement of Burford in the last two and a half years, we have run a series of scenarios depending on the level of unrealised gains recognised in each year.

Exhibit 4: Burford Investment Recovery and Revaluation Scenarios on Petersen and Teinver Cases

	Balance sheet Valuation				
% of Petersen Implied Market Valuation Recognised By Burford Through Last 2.5 Years	30%	50%	66%	100%	Uplift In stages: 20% in 2016, 40% in H2'17 60% in H1'18
	$m	$m	$m	$m	$m
FY'16 balance sheet value	18	18	18	18	18
Gain on 1% sold for $4m, $400m total implied valuation	4	4	4	4	4
FV gain on remaining amount	101	180	244	378	61
FY'16 Total P/L movement	**105**	**184**	**247**	**382**	**65**
FY'16 balance sheet value	119	198	261	396	119
Gain on 9% sold for $36m, $400m total implied valuation	34	34	34	34	34
FV gain reversed out	-9	-16	-22	-34	-6
FV gain on remaining amount	0	0	0	0	0
Gain on 15% sold for $66m, $440m total implied valuation	63	63	63	63	63
FV gain reversed out	-15	-27	-37	-57	-9
FV gain on remaining amount	9	15	20	30	6
H1'17 Total P/L movement	**82**	**69**	**58**	**36**	**89**
FV gain on remaining amount (claim valuation raised to $660m)	59	98	129	195	138
H2'17 Total P/L movement	**59**	**98**	**129**	**195**	**138**
H2'17 balance sheet value	149	248	327	495	198
H1'18 balance sheet value	149	248	327	495	198
Gain on 3.75% sold for $30m, $800m total implied valuatio	29	29	29	29	29
FV gain reversed out	-7	-12	-16	-24	-10
FV gain on remaining amount	30	50	66	100	154
H2'18 Total P/L movement	**53**	**68**	**80**	**105**	**173**
H2'18 balance sheet value of Petersen	171	285	376	570	342
Remaining Petersen Claim Value	629	515	424	230	458
Petersen Claim Value (71.25% stake)	**800**	**800**	**800**	**800**	**800**

	Balance Sheet Valuation				
% of Teinver Implied Market Valuation Recognised By Burford Through Last 2.5 Years	30%	50%	66%	100%	30%
	$m	$m	$m	$m	$m
H1'17 balance sheet value	30	30	30	30	30
FV gain	12	40	62	110	12
H2'17 Total P/L movement	**12**	**40**	**62**	**110**	**12**
H2'17 balance sheet value	42	70	92	140	42
Gain on amount sold	94	94	94	94	94
FV gain reversed out	-29	-57	-79	-127	-29
H1'18 Total P/L movement	**65**	**37**	**15**	**-33**	**65**
H1'18 balance sheet value	0	0	0	0	0

Source: Burford Capital Disclosures, The Analyst Estimates Completed November 2018

We then compare these write ups to the overall gains and losses seen in Burford's income statement from H1'16 to H1'18 and then beyond to include the FY'20 market consensus estimates. This enables us to show the breakdown between Petersen/Teinver related income and the implied income from other cases in each accounting period (Exhibit 5).

Exhibit 5: Impact of Petersen and Teinver Write-Up Scenarios on Burford's Income Statement

Income Statement	H1'16	H2'16	FY'16	H1'17	H2'17	FY'17	H1'18	H2'18	FY'18e	FY'19e	FY'20e	
	$	$	$	$	$	$	$					
Total litigation income	64	76	140	162	157	318	200	144	344	431	599	
Realised Gains	*16*	*32*	*47*	*111*	*12*	*123*	*125*					
Fair Value Movement (net of transfer to realisations)	*46*	*42*	*88*	*50*	*141*	*192*	*71*					
										Consensus		Remaining Petersen
Scenarios of Recoveries on Petersen & Teinver	**H1'16**	**H2'16**	**FY'16**	**H1'17**	**H2'17**	**FY'17**	**H1'18**	**H2'18e**	**FY'18e**	**FY'19e**	**FY'20e**	**Value**
Both Petersen & Teinver written up to 30% of secondary market value												
Total litigation income	64	76	140	162	157	318	200	144	344	431	599	
o/w Petersen	*52*	*52*	*105*	*82*	*59*	*141*	*0*	*53*	*53*	*315*	*315*	*629*
o/w Teinver	*0*	*0*	*0*	*0*	*12*	*12*	*65*	*0*	*65*	*0*	*0*	*0*
o/w Other	*12*	*23*	*35*	*79*	*86*	*166*	*135*	*91*	*227*	*117*	*285*	
Both Petersen & Teinver written up to 50% of secondary market value at each revaluation												
Total litigation income	64	76	140	162	157	318	200	144	344	431	599	
o/w Petersen	*92*	*92*	*184*	*69*	*98*	*167*	*0*	*68*	*68*	*258*	*258*	*515*
o/w Teinver	*0*	*0*	*0*	*0*	*40*	*40*	*37*	*0*	*37*	*0*	*0*	*0*
o/w Other	*-28*	*-16*	*-44*	*93*	*19*	*112*	*163*	*76*	*240*	*174*	*342*	
Both Petersen & Teinver written up to 66% of secondary market value at each revaluation												
Total litigation income	64	76	140	162	157	318	200	144	344	431	599	
o/w Petersen	*124*	*124*	*247*	*58*	*129*	*187*	*0*	*80*	*80*	*212*	*212*	*424*
o/w Teinver	*0*	*0*		*0*	*62*	*62*	*15*	*0*	*15*	*0*	*0*	*0*
o/w Other		*-48*	*-107*	*103*	*-34*	*69*	*185*	*64*	*250*	*219*	*387*	
Petersen write-up In stages - 20% in 2016, 40% in H2'17, 60% in H2'18. Teinver at 30%												
Total litigation income	64	76	140	162	157	318	200	144	344	431	599	
o/w Petersen	*33*	*33*	*65*	*89*	*138*	*227*	*0*	*173*	*173*	*229*	*229*	*458*
o/w Teinver	*0*	*0*	*0*	*0*	*12*	*12*	*65*	*0*	*65*	*0*	*0*	*0*
o/w Other	*32*	*43*	*75*	*73*	*7*	*79*	*135*	*-29*	*106*	*202*	*370*	

Source: Burford Capital Disclosures, The Analyst Estimates Completed November 2018

Notes to explain the above tables:

- Both realised gains from stake sales and fair value movements are included within total litigation income, as calculated in Exhibit 4.

- For each scenario, the potential write-up is based on each claim being a percentage of that implied by secondary market sales. For example, the implied income for Petersen in H2'17 for the 30% scenario of £59m is based on the increase in value on the secondary market from $440m to $660m, but assuming that Burford has only written the claim up from an implied 30% of $440m to 30% of $660m.

- We have split the FY'16 Petersen write-ups equally across H1'16 and H2'16 as we do not know in which half the write-ups were made.

- When looking at the remaining Petersen claim, we assume it settles at a value of ~$1.1bn for Burford's original stake. Burford's remaining stake of 71.25% after the block sales would therefore be ~$800m. The remaining gain under each scenario is allocated to FY'19 and FY'20.

Overall, we see the staged write-ups in the fifth scenario as the most likely outcome. Under this approach, the claim is written up to 20% of its $400m value in FY'16, then to 20% of $440m in H1'17, then to 40% of $660m in H2'17, and finally to 60% of $800m in H2'18. Under this approach, income from non Petersen or Teinver cases was £73m in FY'16, rising to £79m in FY'17 and then to £106m in FY'18 (based on FY'18 consensus).

Consensus estimates for FY'19 and FY'20 litigation income are $431m and $599m respectively (excluding an assumed $25m p.a. of non-litigation income). If the Petersen case was to be settled at $1.1bn in FY'20, then that gives ~$458m of profit contribution to those periods from Burford's remaining stake. To meet consensus estimates, non Petersen or Teinver income would need to increase from £107m in FY'18 to £202m in FY'19 and £370m in FY'20, and these amounts appear optimistic given the one-off nature of Burford's legal cases.

Burford's portfolio at year end FY'17 included $629m of ongoing claims (pre-write-ups), and this included the $31m invested in Petersen and Teinver. Burford invested another $229m in H1'18 and we estimate realised ~$180m of original investments, which would leave $647m invested in the portfolio. There is of course H2'18 remaining for further investments to be made; however, consensus is assuming that Burford can recognise £202m and $370m of non Petersen or Teinver income in FY'19 and FY'20 respectively. This appears highly optimistic.

Burford clearly states, 'we specifically eschew any obligation to correct estimates made by financial analysts or to inform the market should we come to believe that our actual performance will diverge from those estimates' (p32, FY'17 Annual Report). Therefore, any unrealistic estimates for FY'19 and FY'20 would not be downgraded by the company as a matter of policy.

This analysis assumes that the Petersen case is written up no further beyond $1.1bn. The full claim is for ~$4-5bn, reduced by $900m for margin loans and by a further 30% which is allocated to creditors of the bankruptcy. This assumes the claim reaches full conclusion. Earlier settlement would likely reduce the claim by half; hence we arrive at a $1.1bn for Burford's original stake.

We must note the risk of another case arising with Petersen or Teinver scale returns. However, the market today is much more competitive than in 2015, when the Petersen case originated, and we expect that Burford's potential returns would be much smaller should a similar case arise today.

For Burford to meet FY'19 and FY'20 consensus, the Petersen case must continue to proceed to a positive conclusion and very strong returns are needed on the other cases. We see this as too optimistic and believe that consensus estimates for FY'19 and FY'20 revenue are too high.

Other Accounting Points

We note the following other financial concerns regarding Burford:

- Unrealised gains have totalled ~50% of overall Burford profits since initiation. Whilst reporting of these unrealised gains is required under IFRS 9, it does require an enormous level of judgment by the company of valuations that are difficult to audit because the litigation case outcomes are often binary and the secondary market is small and illiquid. In the FY'16 annual report, Burford said it had never reduced the fair value of any investment that it had previously increased and that has now that has changed, with 0.2% of write-ups turning into a loss per the FY'17 annual report. Whilst we have no evidence to suggest that Burford's valuations are unreasonable, there is without doubt risk of some of the ongoing cases being written down in future, particularly the older cases from pre-FY'14.

- The Teinver claim was sold in full for $107m in March 2018; however, if the Teinver award were to be annulled, the sale transaction could be rescinded at the option of the buyers; in that event, Burford would retain a $7m fee and would also have its original entitlement back and be free to pursue the claim again (see p91 of FY'17 annual report). We are surprised that the sale has been fully recognised as income in H1'18.

- Burford spends liberally on external fees, incurring $3.8m of investment banking and brokerage fees in FY'17 relating to sale of an investment in the secondary market – we expect this refers to the $106m of Petersen claim sales in FY'17. However, we question whether Burford is getting value for money.

- Burford is consuming cash rather than generating it. From FY'14 to date, the company has seen a cash outflow of $323m. This business is still raising funds from investors and retail bonds and recently completed a $250m share placing on 02

October 2018 to invest in new opportunities. This is despite seemingly being in a good cash position, with £240m of cash on the balance sheet at H1'18.

Corporate Governance Concerns

We have identified several red flags regarding Burford's corporate governance and shareholder base. None are sufficient to indicate wrongdoing, but we highlight them none the less:

- Burford is a ~£4bn market cap company and yet remains on the Alternative Investment Market rather than move up to the main market. The main market has tighter disclosure and governance requirements than AIM and we ask if this is the reason why the move has not been made.
- CEO Christopher Bogart and CFO Elizabeth O'Connell are married and this tight concentration of power is not ideal from a corporate governance perspective. Before listing Burford, Chris Bogart worked in the Time Warner legal team and then started Churchill Ventures, a technology and media investment fund, in 2006 before founding Burford Capital via its original parent Glenavy Capital. Elizabeth O'Connell was also CFO of Churchill Ventures.
- The company's first four years of existence as a listed company were without a CFO at all. Then, Miriam Connole was appointed CFO in February 2013 before leaving for undisclosed reasons after only one year. The CFO position remained unfilled until December 2017 when Elizabeth O'Connell took on the title, having previously managed the IR and finance functions.
- Andrew Langhoff has left Burford Capital not once, but twice. He joined in 2012 as COO from Dow Jones but left in 2014. Later he joined Gerchen Keller in January 2016, but has left again after the Burford acquisition, again for undisclosed reasons.
- Christopher Bogart and Jonathan Molot placed 4.4m and 4.3m shares respectively (~33% of holdings) at £13.50 per share on 21 March 2018. The RNS suggested this was done to 'create liquidity'.
- Gerchen Keller part of the business appears to be weak with investment management income falling in H1'18 versus H1'17.

Whilst none of these facts indicate any wrongdoing, we note that corporate governance concerns at Burford may move into focus should previously exceptional returns moderate.

Valuation

We value Burford at $3.6bn, implying 24% downside from here, based on these estimates:

- Excluding Petersen, cases completed up to FY'17 were at a ~45% ROIC; we assume 40% ROIC on existing cases that remain to complete.
- We value Burford's 71.25% stake in Petersen at ~$800m (assuming ~$1.1bn recovery for full claim).
- The remaining balance sheet numbers from H1'18 are added, including the £250m rights issue recently raised, to give a $1.675bn balance sheet valuation.
- We expect future cases to generate a lower ROIC than existing cases, and assume the company invests ~$600m p.a. at ~30% ROIC in the medium term. On 10x, that gives $1.8bn of value.
- Gerchen Keller valued at 10x FY'17 EBIT plus remaining small segments at ~10x EBIT. Note that this is relatively aggressive compared to listed asset management businesses where client assets are held off-balance-sheet, such as Jupiter Fund Management Plc (6x FY'17 EBIT) and Schroders (11x FY'17 EBIT).

Exhibit 6: Burford Valuation

Component	Valuation
Investment in ongoing cases at FY'17 (pre-write up)	**629**
New investment in H1'18	229
Original investment in cases realised in H1'18	-192
Estimated total ongoing investment at H1'18 (pre-write up)	**666**
Less: Petersen original investment	-18
Less: Teinver original investment	-13
Litigation investment portfolio pre write up	**635**
Estimated recoveries on investment portfolio (assume @ 40% ROIC on $635m)	**889**
Petersen Case (assume settlement at $1.1bn, implying $800m for Burford's 71.25% stake)	800
Value of remaining balance sheet	-264
Rights issue proceeds	250
Balance Sheet Valuation	**1675**
Franchise value of Future Cases - Assume ~$600m p.a invested at 30% ROIC and put on 10x earnings	1800
Gerchen Keller @ 10x FY'17 EBIT	85
Other segments (Insurance, New Initiatives, Other Income) @ 10x FY'17 EBIT	37
Total Valuation	**3596**
Current Market Cap	4754
Downside	**24%**

Source: The Analyst Estimates Completed November 2018

Conclusion

Burford Capital has pioneered the field of litigation finance and will continue to remain a formidable player in the industry. However, its valuation and consensus estimates have become excessive and we expect the outsized 75% ROIC on cases will not be continued in the future due to the passing of the single Petersen case and increasing competition in the industry.

Furthermore, there are growing corruption allegations in Argentina regarding the source of the actual Petersen claim.

Based on our sum-of-the-parts metric, we value Burford Capital at $3.6bn, or £2.8bn, which gives 24% downside from today's share price to our target of £12.75. This assumes a Petersen valuation of ~$800m, though if the case falls through, then Burford could get nothing from it, reducing the valuation significantly further.

We therefore initiate on Burford Capital with a short recommendation and £12.75 price target, providing 24% downside.

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