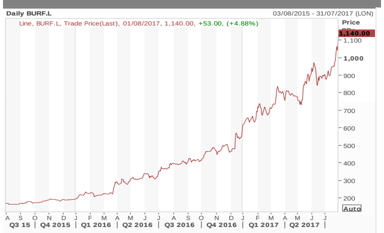
Burford Capital

Another record set of results

Financials



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	BUR
Price (p)	1,087.0
12m High (p)	1,087.0
12m Low (p)	388.4
Shares (m)	208.2
Mkt Cap (£m)	2,263
Total Assets ($m)	1,196
Free Float*	86%
Market	AIM

**As defined by AIM Rule 26*

Description

Burford Capital is a leading global finance and professional services firm focusing on law. Its businesses include litigation finance and risk management, asset recovery and a wide range of legal finance and advisory activities.

Company information

CEO	Christopher Bogart
CIO	Jonathan Molot
Chairman	Sir Peter Middleton

+1 (212) 235-6820
www.burfordcapital.com

Key shareholders

Directors & management	14%
Invesco Perpetual	25.0%
Woodford Investments	10.0%
Aberdeen Asset Mgt	4.9%

Next event

15 Nov-17	Interim dividend paid

Analysts

Brian Moretta 020 7194 7622
bm@hardmanandco.com

Once again Burford has produced record revenue and profits, with some of the 2017H1 figures beating the FY2016 figures. Overall revenue grew 130% to $175.5m with adjusted profit after tax up 170% to $142.7m. The main driver continues to be the litigation finance business, underpinned by the two secondary market sales in the Petersen case which brought in $106m of cash, while de-risking the balance sheet. Profits in this segment grew from $52.6m in 2016H1 to $150.3m. The interim dividend has been increased by 14% to 3.05¢.

- **Other businesses:** Fund management was a little behind our expectations, but will do better in H2 with the addition of fees from the Complex Strategies fund. Asset recovery experienced the volatility of a small book of investments and a shift to focus more on contingent investments. The insurance business continues its expected run-off.
- **Complex Strategies:** Earlier this month Burford announced a $500m fund raise for their new fund, including a $150m investment from its own balance sheet. This introduces some accounting changes, with the timing adding some complications which we explain in this note.
- **Valuation:** With performance again exceeding expectations, Burford's rating has grown at a slower rate than the strong share price performance. The prospective P/E for 2019E is only 17.4 times, while a prospective 16.5% RoE with strong growth suggests strong metrics all round.
- **Risks:** The investment portfolio is now quite diversified, but still has some very large investments, which means revenue may be volatile. The Petersen case provides a concrete example of this. As the company matures we would expect that to decrease, but not to disappear.
- **Investment summary:** Burford has already demonstrated an impressive ability to deliver good returns in a growing market while investing its capital base. As the invested capital continues to grow, the litigation investment business is expected continue to produce strong earnings growth.

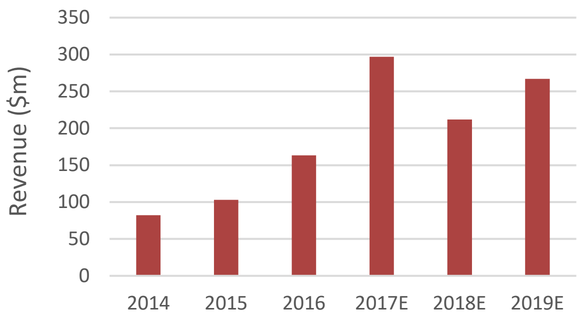
Financial summary and valuation

Year end Dec ($m)	2014	2015	2016	2017E	2018E	2019E
Revenue	82.0	103.0	163.4	302.0	212.0	266.5
Operating Profit	60.7	77.2	124.4	235.2	140.4	184.6
Reported net income	45.4	64.5	108.3	205.9	110.4	153.4
Underlying net income	53.0	64.5	114.2	221.4	122.1	165.1
Underlying Return on Equity	12.1%	16.0%	22.2%	30.7%	13.8%	16.4%
Underlying EPS ($)	0.26	0.32	0.55	1.06	0.59	0.79
Statutory EPS ($)	0.22	0.32	0.53	0.99	0.53	0.74
Dividend per share ($)	0.07	0.08	0.09	0.11	0.12	0.14
Yield	0.5%	0.6%	0.7%	0.8%	0.9%	1.0%
NAV per share ($)	1.87	2.12	2.22	2.94	3.47	4.21
P/E (x) (underlying)	53.3	43.8	25.2	13.0	23.5	17.4
Price/NAV (x)	7.4	6.5	6.2	4.7	4.0	3.3

Source: Hardman & Co Research

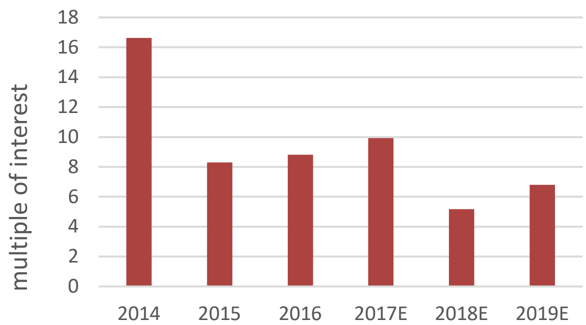
Table of Contents

Revenue



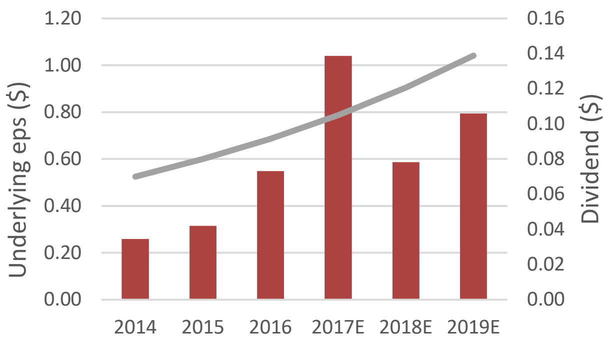
- Growth depends on pace of investment and conclusions
- Accelerated investment in 2016 will boost 2017 and 2018 revenue
- 2017 figures boosted by sales from Petersen case and result of Teinver claim
- Continued investment in the business underpins the growth

Interest Cover



- No debt prior to 2014
- Retail bond issues in 2014, 2016 and 2017
- $43.75m loan note issued for GKC acquisition now redeemed
- 2014 issue was mid-year so only partial accrual of coupon

Eps and dividend



- 2017 results boosted by sales from Petersen case and results of Teinver case
- Full effect of large single $100m investment came through properly in late 2016 and into 2017
- Large single claims may continue to introduce volatility in the future

Source: Burford Capital; Hardman & Co Research

Results Summary

Yet again Burford has produced another outstanding set of interim results, with total income in 2017H1 growing 130% to $175.5m. As usual, this increase was driven by the litigation finance business, in particular the sale from the Petersen case that has been previously disclosed (and discussed in detail in our earlier notes). Stated profit after tax grew 138% to $133.0m, though removing amortisation and one off transaction fees gives an underlying figure of $141.7m.

The interim dividend was increased to 3.05¢, a 14% increase. This was calculated on the usual basis of being one-third of the previous year's figure.

By Division

Litigation Finance

Litigation Finance

$m	2014	2015	2016	2017H1
Income	47.85	87.88	140.19	161.63
Expenses	10.42	15.65	26.02	10.61
PBT	37.43	72.22	114.17	151.02
Tax	0.61	-2.23	4.72	0.72
PAT	**38.04**	**70.00**	**118.89**	**150.30**
Op Mgn	78%	82%	81%	93%

Source: Burford Capital, Hardman & Co Research

The first half provided an outstanding result for litigation finance, with the revenue for this segment exceeding the FY2016 figure. The single largest part of this was the Petersen case[1], where the two sales brought in cash of $106m and generated significant realised gains as well as a fair value adjustment. The exact amount of either of these has not been disclosed, but clearly was a very significant part of the revenue figure.

While the Petersen investment is exceptional in size, it seems somewhat unfair to Burford to strip it (or the Teinver investment) out and consider the residual separately. It has been clear for some time that Burford's portfolio includes investments that are capable of producing results that move results on an individual basis. While such cases force analysts to make adjustments, these are normal for Burford even if timing will always be irregular.

Costs in the first half grew by 8% compared to 1H2016 (after restatement due to the moving of law firm lending from new initiatives). Note these have consistently been higher in the second half of the year. The acquisition of Gerchen Keller (GKC) has led to an integration of their investment team. With most new investments being split between Burford's balance sheet and the funds, there is now a hypothecation of costs between Litigation Finance and Investment Management. This will have had some effect on the growth rate, but Burford has also continued to add to its team, something we see as essential if they are to maintain their growth.

[1] For full discussion of the Petersen transactions and the Teinver case please see our earlier Hardman & Co research notes.

Investment Management

With the acquisition of GKC taking place in mid-December 2016, this is the first reporting period that investment management has made a meaningful contribution. The revenue figure of $7.53m is slightly less than half the (unconsolidated) 2016 result. This includes $1.2m of performance fees from the first GKC fund, slightly earlier than we expected.

The costs of $3.60m were a bit higher than half the 2016 figure. The latter is subject to the same comments made above for litigation finance, as well as noting that the launch of the Complex Strategies fund would incur additional costs.

Operationally, Burford announced the closing of the fundraise for the Complex Strategies Fund at $500m. The close took place as at 30 June. The amount raised was more than the $300m initially targeted and includes $150m from Burford's balance sheet, as well as $5m from staff and management. The fees will be 2% on capital drawn (not the Burford element) plus a 20% performance fee on returns over a 5% per annum priority return. The fund will be run in a similar way to private equity, with capital drawn down from investors when required and returned when realised. Management observe this is probably the largest single pool of money raised in litigation finance to date.

The temporary lines in the balance sheet from the year end relating to the acquisition have now gone, but there is now a goodwill amortisation line in the P&L. Burford is accounting for this under 'Other corporate activity'. As a non-cash item it will be stripped out in Hardman & Co numbers for underlying figures, but included in the statutory ones.

Insurance

Insurance

$m	2014	2015	2016	2017H1
Income	24.34	12.76	12.92	4.62
Expenses	5.40	2.58	1.70	0.91
PBT	18.94	10.19	11.23	3.71
Tax	-3.86	-1.19	-1.61	-0.45
PAT	**15.08**	**9.00**	**9.62**	**3.26**

Source: Burford Capital, Hardman & Co Research

The insurance segment continued its run off, with a revenue decline of 10.5% in line with our estimates. Costs were a little higher and tax somewhat lower giving a 5% decline in profit after tax.

New Initiatives

New Initiatives

$m	2014	2015	2016	2017H1
Income	0.22	2.51	8.85	0.90
Expenses	1.56	2.80	4.90	1.76
PBT	-1.34	-0.29	3.95	-0.86
Tax	0.47	0.00	-0.82	-0.10
PAT	**-0.87**	**-0.29**	**3.14**	**-0.96**

Source: Burford Capital, Hardman & Co Research

Having given a good result in FY2016, the asset recovery result is the only disappointment in these figures. The decline in revenue reflects two factors. Firstly, Burford sees greater value in contingent fee arrangements and have taken this approach in its new business. This means that fees will be more back-end loaded than they were previously. The second factor is the immaturity of the business – with contingent fees this business will have a revenue pattern similar to Burford's main litigation finance business. However, as yet it has not built up a large enough book of business to give a steady flow of revenue and will inevitably be volatile.

Investments on the balance sheet for this segment grew from $2.3m to $3.7m, suggesting that there will be improvement in revenues in due course.

Corporate

It has been a busy first half for the corporate centre. As well as the completion of the transactions for the GKC acquisition, there has been the issue of a new retail bond. This raised £175m with a 5% coupon, with some of the proceeds being used to repay the more expensive loan note from the acquisition. There were also $3.8m 'Investment banking and brokerage fees'.

Having seen a large benefit from currency movements in FY2016, bringing a $35m gain, there was a smaller strengthening of sterling relative to the dollar leading to a $11.1m loss in 2017H1.

Investing

The accounting for Burford's investments has seen some changes with this announcement, primarily due to the Complex Strategies fund into which Burford is making a significant investment ($150m of the $500m total). Going forward this will be consolidated on a line by line basis, with Burford's share of investments and realisations (normally ~30%) being reflected in the litigation finance investments and other balance sheet figures.

The fund raising closed at 30 June, with Burford seeding the fund with investments that it has purchased for this purpose. Though these are being transferred at cost, the timing of this relative to the year end has unfortunately complicated the accounting somewhat. As of the balance sheet date, these investments have been funded solely by Burford, with capital still to be drawn from external investors.

The headline figures for new investments are again very strong. With $488m of new commitments, $226m of which are on Burford's balance sheet and $262m for their funds. On balance sheet contingent commitments grew to $400m from $297m as at 31 December 2016. This report has added an additional $61m of legal risk exposure, where Burford is not expected to deploy capital, but is potentially exposed to costs in the event of a loss.

The on balance sheet investments saw $193m added to new or existing investments, including $123m for the Complex Strategies fund. In the normal course of events Burford's share of this would be ~30% of that total i.e. c$37m, and it is expected that as money is called in from external investors that adjustment will take place, reducing the investment figure. Of course, the fund will not remain static and it is clear that further fund investments will take place. The net effect is that Burford's investment in the fund may reduce from $123m in 2017H2, but most likely to a figure much higher than $37m.

The net effect on Burford's balance sheet is that the underlying investment additions in 2017H1 are approximately $107m. Although this figure is somewhat less than the $158m in 2016H1, that included a $100m portfolio investment and is otherwise larger than all other half year to date. In addition Burford will be getting management fees and, eventually, performance fees on the balance of the fund investments.

Capital

During the first half Burford boosted its cash resources from two significant sources. As previously mention, the retail bond raised £175m, which translated to $227m. The second source was investment realisations, which produced a record half underpinned by the $106m received for the secondary market transactions in the Petersen investment.

Offsetting this has been the strong investments mentioned above, though $86m of the seeding to the Complex Strategies fund can be considered to some extent temporary. Excluding this there is $221.9m of cash or equivalents on the balance sheet. This should be adequate to see Burford through into 2018, even without any realisations. We do note that with $400m of contingent commitments that further funding may well be required in 2018.

Financials and Forecast

We have noted before the difficulty in forecasting Burford's earnings and this set of figures has been no exception. From the partial sales in the Petersen case we had forecast an aggregate fair value movement of $75m. Given the total fair value movement for 2017H1 was $50.4m this was clearly too optimistic, though we cannot determine if the previous valuation was higher than we thought or if the new valuation is more conservative. Regardless, we have to make an adjustment to our 2017E figures and have reduced the fair value movement for the investment to $30m.

The principle offset to that is the Teinver investment, which we discussed in our note of 24th July. We have made a small upward adjustment, though we have to allow for these being 'business as usual'. We have slightly increased our expected average return a little, which has had a positive effect on 2018E and 2019E.

Other items we have adjusted are:

- For asset recovery we have significantly downgraded our revenue expectations. This has been the biggest influence on our 2018E and 2019E profits.
- Expenses, with fund management and asset recovery both moved lower and with insurance a little higher.
- Amortisation of the intangible asset in our statutory figures.
- Small changes to tax and as a consequence of exchange rates.

The net result of these is a downgrade of our underlying 2017E eps to 106¢, with smaller movements on our 2018E to 59¢ and 2019E to 79¢.

Summary financials

Year end Dec ($m)	2014	2015	2016E	2017E	2018E	2019E
Revenue	82.0	103.0	163.4	302.0	212.0	266.5
Expenses	21.3	25.8	39.0	51.3	59.9	70.2
Operating Profit	**60.7**	**77.2**	**124.4**	**235.2**	**140.4**	**184.6**
Finance cost	3.7	9.3	14.1	23.2	27.1	27.1
Exceptional items	-9.7	0.0	-5.9	-3.8	0.0	0.0
Reported pre-tax	**47.3**	**67.9**	**104.1**	**211.8**	**113.0**	**157.2**
Reported taxation	-0.7	-2.2	4.8	-5.9	-2.6	-3.8
Minorities	1.2	1.2	0.6	0.0	0.0	0.0
Underlying net income	**53.0**	**64.5**	**114.2**	**221.4**	**122.1**	**165.1**
Statutory net income	45.4	64.5	108.3	205.9	110.4	153.4
Underlying Basic EPS ($)	**0.26**	**0.32**	**0.56**	**1.06**	**0.59**	**0.79**
Statutory Basic EPS ($)	0.22	0.32	0.53	0.99	0.53	0.74
Dividend ($)	0.07	0.08	0.09	0.11	0.12	0.14
Balance sheet						
Total equity	382.7	433.1	462.2	612.7	723.1	876.6
Invested Capital	207.5	252.9	394.3	532.1	689.9	870.6
Fair Value Balance	266.8	334.2	559.7	820.3	1,084.3	1,401.3
Total Assets	**533.2**	**608.7**	**826.4**	**1,224.8**	**1,335.2**	**1,488.6**
NAV Per share ($)	1.87	2.12	2.22	2.94	3.47	4.21
Return on Equity	**12.4%**	**15.8%**	**21.0%**	**30.7%**	**13.8%**	**16.4%**

Source: Hardman & Co, £1=$1.31

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Hardman & Co Research Limited (trading as Hardman & Co)
35 New Broad Street
London
EC2M 1NH
T +44 (0) 207 194 7622

Follow us on Twitter @HardmanandCo

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Hardman Team

Management Team

+44 (0)20 7194 7622

John Holmes	jh@hardmanandco.com	+44 (0)207 194 7629	Chairman
Keith Hiscock	kh@hardmanandco.com	+44 (0)207 194 7630	CEO

Marketing / Investor Engagement

+44 (0)20 7194 7622

Richard Angus	ra@hardmanandco.com	+44 (0)207 194 7635
Max Davey	md@hardmanandco.com	+44 (0)207 194 7622
Antony Gifford	ag@hardmanandco.com	+44 (0)207 194 7622
Vilma Pabilionyte	vp@hardmanandco.com	+44 (0)207 194 7637
Gavin Laidlaw	gl@hardmanandco.com	+44 (0)207 194 7627
Ann Hall	ah@hardmanandco.com	+44 (0)207 194 7622

Analysts

+44 (0)20 7194 7622

Agriculture

Doug Hawkins	dh@hardmanandco.com
Yingheng Chen	yc@hardmanandco.com
Thomas Wigglesworth	tcw@hardmanandco.com

Bonds

Brian Moretta	bm@hardmanandco.com
Mark Thomas	mt@hardmanandco.com

Building & Construction

Tony Williams	tw@hardmanandco.com
Mike Foster	mf@hardmanandco.com

Consumer & Leisure

Mike Foster	mf@hardmanandco.com
Steve Clapham	sc@hardmanandco.com
Jason Streets	js@hardmanandco.com

Financials

Brian Moretta	bm@hardmanandco.com
Mark Thomas	mt@hardmanandco.com

Life Sciences

Martin Hall	mh@hardmanandco.com
Gregoire Pave	gp@hardmanandco.com
Dorothea Hill	dmh@hardmanandco.com

Media

Derek Terrington	dt@hardmanandco.com

Mining

Paul Singer	if@hardmanandco.com

Oil & Gas

Angus McPhail	am@hardmanandco.com

Property

Mike Foster	mf@hardmanandco.com

Services

Mike Foster	mf@hardmanandco.com

Special Situations

Steve Clapham	sc@hardmanandco.com
Paul Singer	ps@hardmanandco.com

Tax Enhanced Services

Brian Moretta	bm@hardmanandco.com
Chris Magennis	cm@hardmanandco.com

Utilities

Nigel Hawkins	nh@hardmanandco.com

Hardman & Co

35 New Broad Street
London
EC2M 1NH

Tel: +44(0)20 7194 7622

www.hardmanandco.com