HARDMAN&CO.

5 August 2019

BURFORD CAPITAL

Results don't need to be appealed

Burford has announced its interim results for 1H'19 and has produced another excellent set of figures. After stripping out third-party interests, revenue was up 40% to $287m and earnings grew 36% to $225m. Litigation investment was again the star, with income also increasing 36% to $265m. While this saw some benefit from the recent Petersen transaction, there were strong results beyond that with the rest of the portfolio producing a first-half RoIC of 78%. These brought total recoveries to $1.16bn from 99 investments, with a cumulative RoIC of 98% (from 85% to 31 December 2018) and IRR of 32% (from 30%).

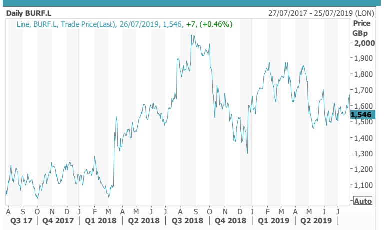
- **New commitments:** It was good to see a return to growth in commitments, with 36% growth to $751m in the half-year; 2018 had been relatively flat compared with 2017. Deployments had slower growth of 8%, affected by a $130m portfolio investment for which the entire deployment is deferred.
- **Cash and capital:** Cash generation from operations was $184m, although payment of receivables since 30 June would have lifted this by $126m. Deployments in the half were $198m. So, period-end cash of $171m, has risen to $297m now, slightly in excess of the $277m in place at 31 December 2018.
- **Risks:** The investment portfolio is highly diversified, with exposure to more than 1,100 claims. However, it retains some very large investments, which means revenue could be volatile, particularly in the smaller divisions. The Petersen case shows that this volatility is not simply a negative.
- **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 expand, we would anticipate that the litigation investment business will continue to generate strong earnings growth.

Financial summary and valuation

Year-end Dec ($m)	2013	2014	2015	2016	2017	2018
Revenue	60.7	82.0	103.0	163.4	341.2	420.7
Operating profit	42.5	60.7	77.2	124.4	285.1	353.0
Reported net income	2.6	45.4	64.5	108.3	249.3	317.4
Underlying net income	40.1	53.0	64.5	114.2	264.8	327.8
Underlying RoE	11.7%	12.1%	16.0%	22.1%	35.9%	30.1%
Underlying EPS ($)	0.20	0.26	0.32	0.55	1.27	1.50
Statutory EPS ($)	0.01	0.22	0.32	0.53	1.20	1.51
DPS ($)	0.05	0.07	0.08	0.09	0.11	0.13
Dividend yield	0.2%	0.3%	0.4%	0.4%	0.5%	0.6%
NAV per share ($)	1.72	1.87	2.12	2.22	3.19	5.50
P/E (underlying, x)	101.6	77.1	63.3	36.4	15.7	13.3
Price/NAV (x)	11.6	10.7	9.4	9.0	6.3	3.6

Source: Hardman & Co Research

Financials



Source: Refinitiv

Market data

EPIC/TKR	**BUR**
Price (p)	**1,539.0**
12m High (p)	2,040.0
12m Low (p)	1,298.0
Shares (m)	218.6
Mkt Cap (£m)	3,365
Total assets ($m)	2,249
Free Float*	90%
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
CFO	Elizabeth O'Connell
Chairman	Sir Peter Middleton

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Key shareholders

Directors	8.2%
Invesco Perpetual	13.9%
Woodford Investments	9.5%

Diary

5 Dec	Interim dividend paid

Analyst

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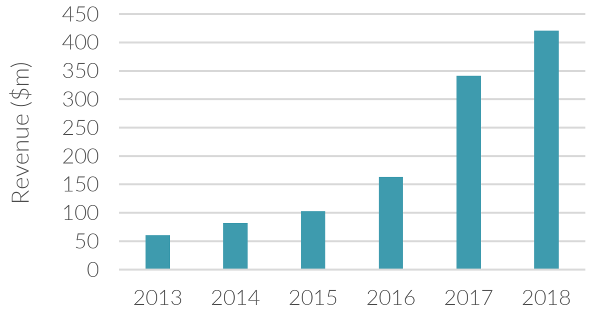
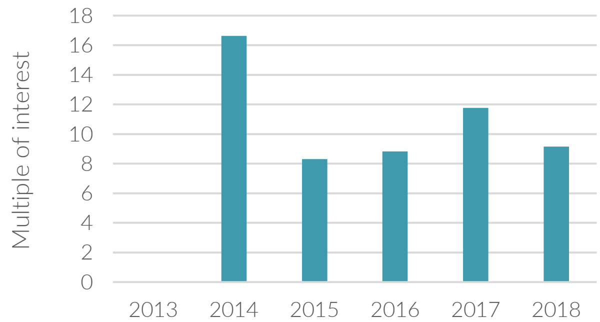
Revenue



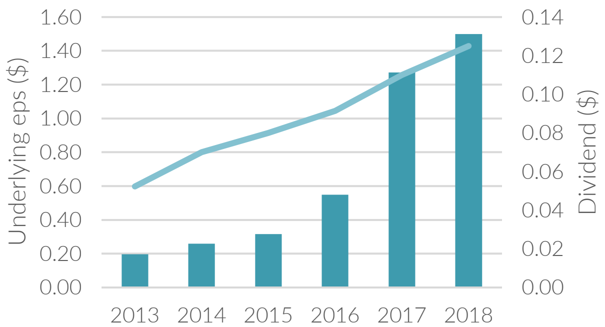
- Long-term growth has correlated strongly with the pace of investment and conclusions
- Accelerated investment from 2017 has boosted revenues
- 2017, 1H'18 and 1H'19 figures were boosted by sales from the Petersen case and the results of the Teinver claim
- New SWF arrangement will deliver a higher proportion of the returns on capital deployed, but has lowered Burford's capital deployment needs

Interest cover (x)



- Retail bond issues in 2014, 2016, 2017 and 2018
- Cash needs and debt issuance are dependent on the rate of investment and the proceeds from realisations
- Interest cover is very strong and Burford has ample capacity to issue further debt

EPS (bar) and DPS (line)



- 2017, 1H'18 and 1H'19 results were boosted by sales from the Petersen case and the results of the Teinver claim
- Growth in the pace of investment has driven returns
- Some large, single claims have brought volatility, although this has been to the upside as well as the downside

Source: Company data, Hardman & Co Research

Results summary

The first half 2019 saw the final resolution of Teinver and a further secondary sale of part of the Petersen claim, although Burford experienced more broad-based progress in the period than just these headliners. Results were again record-setting and ahead of expectations.

As usual, Burford splits out the effect of the consolidation of the complex strategies and other private funds, so investors can see the company's underlying economic performance. While this is very helpful, and is the basis of our analysis and reporting, this is not done on a line-by-line basis, which can lead to some minor discrepancies between the numbers that we quote in different areas.

Headline figures showed strong growth, with total revenues up 40% to £287m and earnings increasing by 36% to £225m. The interim dividend was raised to 4.17¢, an increase of 14% over the 3.67¢ in 2018.

Results by division

Litigation investment

Litigation investment

$m	2016	2017	2018	1H'19
Income	140.19	318.23	389.50	264.99
Expenses	26.02	33.54	39.04	20.34
PBT	114.17	284.69	350.46	244.65
Tax	4.72	2.41	15.19	-3.51
PAT	118.89	287.11	365.65	241.14
Operating margin	81%	89%	90%	92%

Source: Burford Capital, Hardman & Co Research
Assumption: the expense adjustment for the fund reconciliation is all in this division

1H'19 figures again demonstrated the strength of Burford's investment approach, as revenues in this business increased 36% compared with 1H'18. The contribution from Teinver was only $7m. The Petersen sale generated $100m in cash, but the gain booked in this half will be the surplus over the fair value as of the year-end. This latter is not disclosed, so all we can say for certain is that it is less than the $98m gain over investment and more than the $20m uplift implied by marking the full share of the claim to the implied transaction prices.

Of the gains, 49% were unrealised and 51% realised, the former slightly down on the past couple of years.

Expenses showed a substantial increase over the same period last year, but were more comparable with the second-half run rate. In Burford's presentation, it highlighted the additional staff it has recruited. The Burford process remains dependent on staff capacity, so investment in growing that is welcome.

Operating margins are almost without peer, but Burford believes it can improve efficiencies. Over the past couple of years, it has built an in-house origination team. There are signs that by pre-qualifying the investments, the efficiency of the underwriting process may be improved. While this is welcome, the main driver of this business will remain its ability to invest and grow revenue.

Investment management

Investment management			
$m	2017	2018	1H'19
Income	15.63	15.80	9.71
Expenses	7.16	12.18	6.27
PBT	8.47	3.62	3.44
Tax	-3.01	-0.16	-0.06
PAT	5.46	3.46	3.38

Source: Burford Capital, Hardman & Co Research

With investor commitments in this business having grown to almost $2bn (the fair value AUM is $2.8bn), there has been an increase in revenues from management fees. There is no news on performance fees, although the figures suggest these remain small. Costs are in line with the second-half run rate from last year.

The complex strategies fund has also been active during the year – an average of 79% deployed in the first half. Burford again highlights the quicker turnover in this portfolio, with IRRs attractive while RoIC is lower than for the main litigation investment business.

In April, Burford closed a new post-settlement fund, raising $300m. This is a replacement fund for the one that already follows this strategy. The latter is in realisation mode and all new investments in this area will be directed into the new fund. This is a lower return strategy than for litigation investment and Burford has not invested any money into the fund.

Insurance

Insurance				
$m	2016	2017	2018	1H'19
Income	12.92	7.61	10.41	2.06
Expenses	1.70	2.00	1.99	0.58
PBT	11.23	5.61	8.41	1.48
Tax	-1.61	-0.66	-0.88	0.08
PAT	9.62	4.95	7.53	1.56

Source: Burford Capital, Hardman & Co Research

After a surprisingly positive result in 2018, the insurance division resumed its expected decline in revenues to $2.06m, compared with $2.89m in 1H'18. Costs are being managed appropriately and the division remains nicely profitable, albeit it is now very small in the context of Burford as a whole.

There is little news on the new adverse costs business. It has been open for over a year, but does not seem to have written much business yet. The total contingent liability for adverse costs was up from $72.5m at year-end to $76.7m as of 30 June.

New initiatives

New initiatives				
$m	2016	2017	2018	1H'19
Income	8.85	2.97	9.53	6.29
Expenses	4.90	2.27	4.37	3.11
PBT	3.95	0.70	5.16	3.18
Tax	-0.82	-0.24	-0.14	0.04
PAT	3.14	0.46	5.02	3.22

Source: Burford Capital, Hardman & Co Research

The revenues for the asset recovery business showed positive volatility in 1H'19, increasing more than six-fold compared with the same period in 2018, although down on the second-half figure of $8.5m. With a relatively small book of business, and the revenues to date coming from a small number of claims, such volatility should not be surprising to investors.

The run rate for new investments continued at an almost identical rate to the second half of last year, at $53.2m. Notably, the division has committed to its first portfolio investments. Although still small relative to the litigation investment division, it has grown quickly, and, at 5% of the balance sheet, it is no longer de minimis. Nevertheless, the total number of claims remains small, with the implications that brings.

Corporate

The first half of the year was particularly quiet on the corporate side, with no fundraisings. The overall tax rate remains low at less than 3%, with no change in guidance on how that will develop over time.

In the interim report, Burford added a Q&A about some items that seem to be asked frequently. Having followed this company for some time, this analyst notes that Burford has remained consistent on many of these points, such as the market it is listed on and the composition of the board. It has also been clear, and consistent, on its accounting approach, even if the rules prevent it being as simple as we might like. There is no perfect company, but if these areas are the worst the bears can come up with on Burford, then the company is doing pretty well!

Investments

Although the secondary sale of Petersen was not small, the bulk of returns in the first half came from the wider investment portfolio.

Cumulative returns

	2015	2016	2017	2018	1H'19
RoIC	70%	60%	75%	85%	98%
IRR	28%	27%	31%	30%	32%

Source: Burford Capital, Hardman & Co Research

Petersen certainly helped with realisations, which were $302m in 1H'19. The figure was slightly down on the comparable period last year, although this included the sale on Teinver, which was a larger transaction. The net realised gain was slightly higher at $125m, compared with $121m.

Looking at investments concluded in the half alone, the RoIC was 390%, or 78% if Petersen is excluded. Given this figure is in line with the previous long-run averages, it suggests that the pricing pressure that some investors fear has not materialised. There was another $8m realisation in complex strategies, giving a RoIC of 46%.

Overall recoveries are now up to $1.16bn, with $573m of profits. This year's results had the effect of increasing the cumulative RoIC to 98%, and the IRR to 32%. Burford stresses that it doesn't see this increase as a trend. We note the 98% RoIC is a bit ahead of where Burford has previously indicated its pricing is, supporting that statement.

In the interim report, Burford makes the analogy with venture capital, with some analysts wanting to disregard their "home runs". It notes that if Petersen is excluded, the overall cumulative RoIC is still 59%. We note that, back in 2012, the cumulative return was lower than this figure and has improved since, even before Petersen and Teinver. From a statistical perspective, there is not yet a complete cohort of size to look at, with some investments for each year from 2010 still to be resolved.

The average duration of realisations in the first half dropped slightly from 1.8 years in the whole of 2018 to 1.7 years. Interestingly, while in the past Burford has guided towards an expected duration of 2 years, it has yielded to the data and now suggests that 1.5 to 2 years is perhaps a reasonable range.

New investments

Litigation investments

$m	2016	2017	2018	1H'19
Additions	271.6	414.9	624.6	129.0
Invested capital	394.3	631.4	902.0	849.3
Fair value	559.7	982.2	1,480.2	1,566.3
FV/IC	142%	156%	164%	184%

Source: Burford Capital, Hardman & Co Research

Burford again managed strong growth in both commitments and overall deployments, although the picture on the latter is more complicated than usual. On balance sheet deployments actually declined to $198m from $251m in the previous year.

There are several moving parts here. Most notable is that the new arrangement with the Sovereign Wealth Fund (SWF) started. Under this arrangement, Burford will deploy a lower proportion of capital in new investments than previously (a net of 42% for each), but will get a higher proportion of the return than before (60% of the total, including 5% from performance fees). With $26m being deployed and $112m committed from the SWF pool, this has had a significant effect.

Burford has also committed to a $130m portfolio transaction with a large global corporate client. This appears to be innovative in nature and Burford, understandably, is keeping the details confidential. The relevant feature here is that, unlike most investments, while there is a capital commitment, no money has been deployed up front. If we excluded this investment, the new commitments to deployments ratio would have been almost the same as in 1H'18.

Burford notes that it expects the profitability on this transaction to be comparable with other investments. It also hopes to be able to use this as a template and clearly intends to market this to other potential clients.

With realisations again strong, the net effect is that invested capital fell slightly in the first half. The SWF arrangement is particularly relevant for investors, with new on-balance sheet investments bringing a higher proportion of returns than previously.

Burford notes that the Buford Opportunity Fund (BOF), which was raised in 2018, is 63%-committed after seven months of its three-year investment period and the SWF capital is 25%-committed. Both of those levels are higher than expected.

Added information on investments

At the interims, Burford supplies less additional information than it does at the full-year results. Nevertheless, there are some points worth highlighting:

- Although portfolio investments continue to be more significant than single-case investments, the latter seem set to continue with new clients being complemented by those for whom a portfolio transaction is not possible; for example, liquidation trustees.
- Although complex strategies investments represent 15% of new commitments, their shorter duration and interaction with the fund means that their weight in the overall portfolio has actually shrunk from 14% to 8%.

- Petersen: there is no additional news since the June announcement. The case has now gone to trial and Burford clearly expects a lot of noise as the case proceeds.

Burford has also continued the new detailed disclosure on its individual investments and will update on a half-yearly basis. This will be available in August.

Balance sheet

From a balance sheet perspective, the only items in the first half were operational.

Litigation investments

$m	2016	2017	2018	1H'19
Litigation investments	559.7	982.2	1,459.5	1,566.3
Cash investments & equivalents	169.5	131.4	277.4	171.4
Due from litigation investments	40.1	4.8	37.1	172.85
Goodwill & intangible asset	173.3	161.7	152.2	147.41
Total assets	**968.2**	**1,318.0**	**2,056.3**	**2,249.9**
Debt	274.0	486.9	638.7	637.8
Equity	596.2	798.6	1,091.4	1,567.0
Net gearing	18%	45%	33%	30%
Gross gearing	46%	61%	59%	41%

Source: Burford Capital, Hardman & Co Research

Burford has been very good at keeping its receivables low, but they increased markedly with these results. It appears to be a timing issue associated with settlements bridging the period end, with $126m having been received so far in July. The residual of $46m is comparable with previous figures, especially allowing for the growth of the business.

Slide 13 of the results presentation gives the waterfall for sources and application of cash, with the figures given in the table below.

Principal sources and applications of cash in 1H'19

Source	Amount ($m)	Applications	Amount ($m)
Cash at start of year	277	Operating expenses	36
Cash generated from operations	184	Finance costs and dividends	38
		Investment deployments	198
		Net change in receivables/payables	18
		Cash at year-end	171

Source: Burford Capital, Hardman & Co Research

The net position from operations in the half alone was a net investment of $108m, although allowing for the payments made since 30 June brings a net improvement of $20m to $297m. In this respect, the reduced balance sheet deployment under the SWF arrangement has worked in Burford's favour.

We have previously highlighted that litigation finance is a growth industry, and Burford is the largest investor in the market. The investments themselves are naturally cash-generative on conclusion. Burford could have reined in its growth and invested less capital than it has. By doing this, it could have been self-funding, but this would have produced lower profits for investors. It seems to this analyst that even if the RoIC on Burford's investments was half what it has been, then the company would have been foolish not to fill its boots. Investments returning 70%-90% gross over two years compare favourably with funding at 5%-6%, even after costs. At the achieved level of returns, it seems sensible for Burford to invest whatever it can into litigation investment, even if that means being a net consumer of cash.

Burford has previously indicated it would like to issue a bond. It has not done so due to the current uncertainty in the market, much of which appears to be Brexit-driven. However, there does not seem to be a pressing need to do so. We note that the previous bond issues have funded quickly and been oversubscribed, helped by a shortage of new offers in the retail bond market.

The SWF arrangement has changed the balance sheet requirements for Burford's deployments. Since the turn of the year, deployment on new investments has been 42% to the balance sheet, 33% to the SWF and 25% to BOF. BOF has approximately $111m of capacity left. Historically, Burford has raised new funds when the existing ones become invested, although there has usually been a small gap between them.

Contingent commitments on the balance sheet rose to $708m compared with $553m a year ago and $646m at the year-end. Burford estimates it will have to fund less than half of these over the next 12 months.

To place the cash resources into context, Burford deployed $198m of balance sheet capital in the first half and $386m in the second half of last year. Investors also need to take into account the growth in contingent commitments, the SWF arrangement as well as the utilisation of BOF when assessing Burford's likely requirements.

Plc matters

Staffing

We have noted earlier that Burford has continued to grow its staff. The geographical expansion last year, with new offices in Sydney and Washington, has also brought further recruitment. Burford now has ca.60 lawyers and 120 employees, still a remarkably small number given the scale of the business.

Financials

Summary financials

Year-end Dec ($m)	2013	2014	2015	2016	2017	2018
Revenue	60.7	82.0	103.0	163.4	341.2	420.7
Expenses	18.1	21.3	25.8	39.0	52.3	66.8
Operating profit	**42.5**	**60.7**	**77.2**	**124.4**	**285.1**	**353.0**
Finance cost	0.0	3.7	9.3	14.1	24.3	38.5
Exceptional items	-40.4	-9.7	0.0	-5.9	-3.8	0.0
Reported pre-tax profit	**2.1**	**47.3**	**67.9**	**104.1**	**249.2**	**305.0**
Reported taxation	0.5	-0.7	-2.2	4.8	0.1	12.5
Minorities	0.1	1.2	1.2	0.6	0.0	0.0
Underlying net income	**40.1**	**53.0**	**64.5**	**114.2**	**264.8**	**327.8**
Statutory net income	2.6	45.4	64.5	108.3	249.3	317.4
Underlying basic EPS ($)	**0.20**	**0.26**	**0.32**	**0.55**	**1.27**	**1.50**
Statutory basic EPS ($)	0.01	0.22	0.32	0.53	1.20	1.51
DPS ($)	0.05	0.07	0.08	0.09	0.11	0.13
Balance sheet (@31 Dec)						
Total equity	351.5	382.7	433.1	462.2	664.5	1,202.7
Invested capital	173.6	207.5	252.9	394.3	631.4	902.0
Fair value balance	214.9	266.8	334.2	559.7	982.2	1,480.2
Total assets	**376.1**	**533.2**	**608.7**	**968.2**	**1,318.0**	**2,127.3**
NAV per share ($)	1.72	1.87	2.12	2.22	3.19	5.50
Underlying RoE	**11.7%**	**12.4%**	**16.0%**	**22.1%**	**35.9%**	**30.1%**

Source: Hardman & Co Research
£1=$1.25

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The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

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