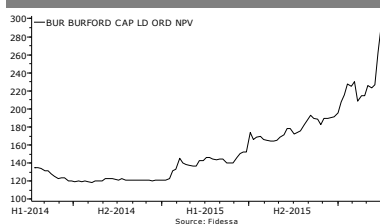


FTSE sector: Financials



Source: Fidessa

Market data

EPIC/TKR	BUR
Price (p)	281.0
12m High (p)	291.5
12m Low (p)	139.5
Shares (m)	204.5
Mkt Cap (£m)	497.0
Total assets (\$m)	540.6
Free Float*	87%
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, insurance, law firm lending, corporate intelligence and judgement enforcement, bankruptcy, litigation funding, advisory and professional services and a wide range of professional activities.

Company information

CEO	Christopher Bogart
CIO	Jonathan Molot
Chairman	Sir Peter Middleton
	+1 (212) 235-6820
	www.burfordcapital.com

Key shareholders

Directors	13%
Invesco Perpetual	29.9%
Woodford Investments	10.1%
Fidelity Worldwide	9.5%
Aberdeen Asset	6.0%
Reservoir Capital	5.6%

Next events

AGM	17 May 2016
Capital Markets Day	18 May 2016
Interim Results	27 July 2016

Analysts

Brian Moretta	020 7929 3399
	bm@hardmanandco.com

Burford Capital

Great results and step change in investments

The 2015 results were excellent. With income growing 26% to \$103m and operating profit up 27% to \$77.2m, Burford continues to show the benefits of its careful investment policy. A single case with a return of \$61m caught the headlines, but the benefits of diversification were evident with 16 investments contributing to cash flow from litigation investment of \$140m. The return on invested capital from investments is now a cumulative 70%. The results further confirm Burford's ability to produce impressive financial returns while generating meaningful growth.

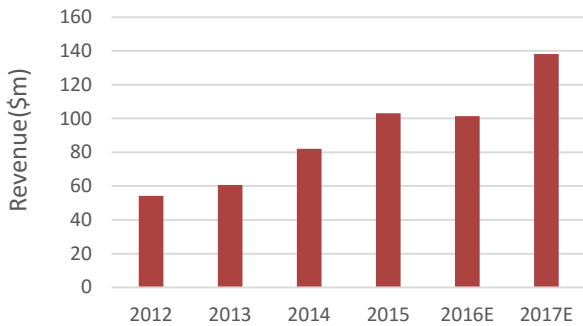
- ▶ **Investment:** Last year Burford made 18 new investments and commitments of over \$200m. At year end the fair value of investments was \$320m with \$213m of contingent commitments. Since then it has made an additional investment of \$100m, boosting invested capital from 54% of equity a year ago to 77% now.
- ▶ **Retail bond:** Burford maintains a strong balance sheet. The additional investment leaves it able to fulfil its commitments, but possibly limited if larger opportunities are found. In order to be able to take full advantage Burford will be issuing another retail bond shortly.
- ▶ **Valuation:** The upgrades to our 2017E figures suggest that Burford remains undervalued relative to its potential. The prospective P/E for 2017E is just 10.2 times. With the additional investment we believe an RoE in the 15-17% range is sustainable while still growing its invested capital quickly.
- ▶ **Risks:** The investment portfolio is fairly focused with some very large investments, which means revenue may be volatile. As the company matures we would expect that to decrease, but not to disappear. As expected, revenue from the insurance business is declining post the adoption of the Jackson reforms.
- ▶ **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 should continue to produce strong earnings growth.

Financial summary and valuation

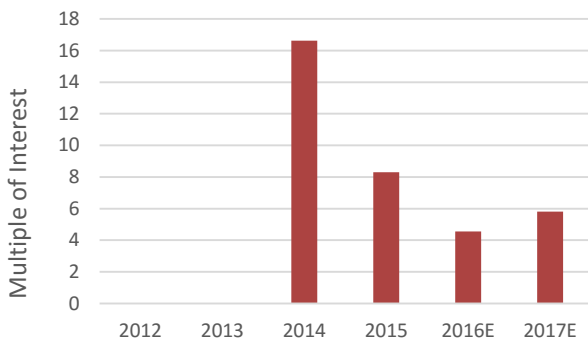
Year end Dec (\$m)	2012	2013	2014	2015	2016E	2017E
Revenue	54.2	60.7	82.0	103.0	101.3	138.1
Operating Profit	34.1	42.5	60.7	77.2	72.2	104.8
Reported net income	17.4	2.6	45.4	64.5	53.2	82.9
Underlying net income	31.6	40.1	53.0	64.5	53.2	82.9
Underlying Return on Equity	9.7%	11.7%	12.1%	16.3%	12.0%	16.7%
Underlying EPS (\$)	0.15	0.20	0.26	0.32	0.26	0.41
Statutory EPS (\$)	0.10	0.01	0.22	0.32	0.26	0.41
Dividend per share (\$)	0.05	0.05	0.07	0.08	0.09	0.10
Yield	1.2%	1.3%	1.8%	2.0%	2.3%	2.5%
NAV per share (\$)	1.62	1.72	1.87	2.12	2.30	2.62
P/E (x) (underlying)	25.8	20.3	15.4	12.7	15.4	9.8
Price/NAV (x)	2.5	2.3	2.1	1.9	1.7	1.5

Source: Hardman & Co Research

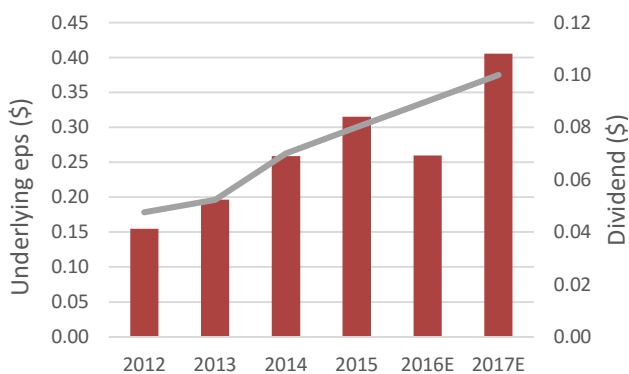
Revenue



- ▶ Growth depends on pace of investment and conclusions.
- ▶ Accelerated investment in 2016 will boost 2017 revenue.
- ▶ 2016E litigation income flat with no repeat of large gain in 2015.



- ▶ No debt prior to 2014.
- ▶ Retail bond issues in 2014 and 2016.
- ▶ 2014 issue mid-year so partial accrual of coupons.



- ▶ 2016E affected by additional coupon and staff recruitment.
- ▶ Full effect of additional \$100m investment seen in 2017.
- ▶ 2015 boosted by large gain.

Source: Company data; Hardman & Co Research

Another good year

Burford produced an outstanding set of result in FY2015. Total income grew 26% to \$103m driven by an 82% growth in litigation investment income to \$86.9m. On an underlying basis (excluding amortisation and currency gains) net income grew 39% to \$66.5m.

The dividend was increased to ¢8, a 14% increase over the 2014 dividend. The growth is enhanced further for investors receiving it in sterling by the strength of the US Dollar.

By Division

Litigation Investment

Litigation Investment				
	2012	2013	2014	2015
Income	32.46	38.85	47.85	86.90
Expenses	11.16	9.01	10.42	13.95
PBT	21.30	29.84	37.43	72.95
Tax	0.00	0.56	0.61	-2.23
PAT	21.30	30.40	38.04	70.73
Op Mgn	66%	77%	78%	84%

Source: Burford Capital, Hardman & Co Research

As indicated above, the biggest factor in the good 2015 results was the growth in income from the litigation investments. Much of this reflects the ongoing growth in investments and the ongoing maturing of these, though there was a significant boost in 2015H1 from a single investment that gave a profit of \$36m. We know that Burford has a few investments that could give large results – the annual report highlights three from 2010 that would give big results if successful. We should expect more in the future, though probably not every year. It is worth noting however that returns were still broad based, with 16 different investments making cash payments.

Costs in this segment grew by 34% in 2015. Some of this is due to investing in growing capacity, some due to a reallocation of shared costs from the insurance business as it has shrunk. Although the economies of scale are limited – assessing investments is very much a people and hours business – the ongoing maturing of Burford has led to improved margins. We expect this to continue as the increased investment grows income.

Other businesses

Litigation Insurance				
	2012	2013	2014	2015
Income	16.15	20.91	24.34	12.76
Expenses	5.09	6.78	5.40	2.58
PBT	11.07	12.96	18.94	10.19
Restructuring	0.00	-1.17	0.00	0.00
Tax	-2.55	-2.84	-3.86	-1.19
PAT	8.52	10.12	15.08	9.00

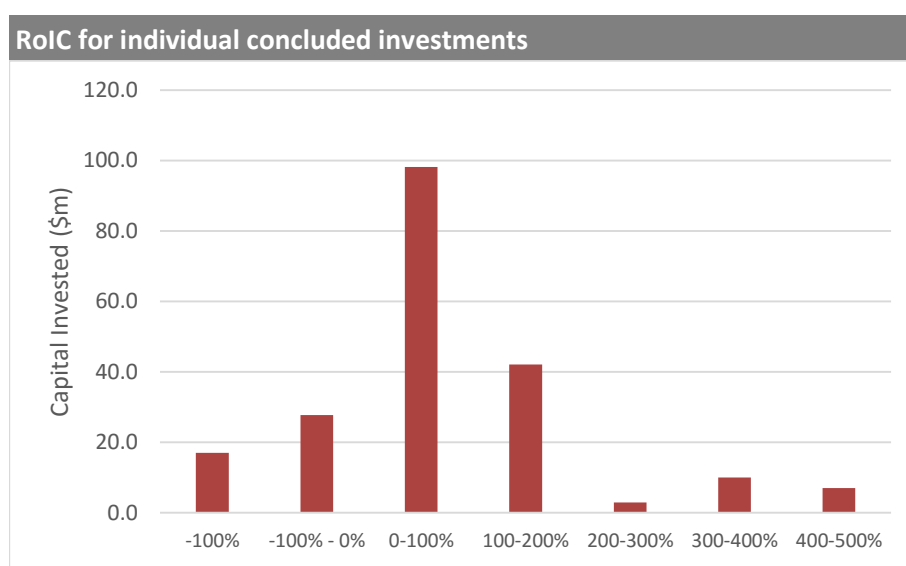
Source: Burford Capital, Hardman & Co Research

For the insurance business, 2015H2 produced a similar revenue level to the first half, producing the only disappointment within the results as we had forecast a pickup. With this business being UK based, currency accounted for roughly \$1m of the revenue decline. The REME, the gross measure of exposure, declined by a much smaller percentage from \$232m to \$180m, of which \$10m was currency changes. Burford observe that there was a lack of larger cases in 2015 and it may reflect a quiet period. Given the revenue decrease in 2015 we now expect a slower rate of decline going forward. Investors should note the growth in litigation investment has much reduced its importance to the group - it brought 15% of PBT in 2015 compared to 33% in 2014.

The new initiatives produced revenue of \$3.5m and a loss of \$1.0m. Both businesses are showing good signs of progress, but not material yet for the group as a whole. Burford indicated that it is in the process of obtaining a license that will allow it to make equity investments into UK law firms, though at this stage that provides an option and no investments are planned yet.

Updated Analysis of Investments

As we have indicated before, while individual investments can catch the headlines, Burford's biggest attraction is its diverse portfolio of investments. In 2015 concluded cases produced \$139m of gross realisations and interest, \$65m of realised gains and \$140m of cash flow. The cumulative return on invested capital is now 70% with an IRR of 28%.



The figure shows the pattern of return on invested capital for individual investments. To date Burford has made a net gain in 71% of cases, with only 14% showing a complete loss. During the year Burford continued to add more multiple and complex investments than single cases and the latter are now only 33% of the portfolio. Given this we expect the spread on this chart to narrow over time. For example, if we use 14% as the estimate of complete loss, then in a portfolio of three independent cases the probability of complete loss would be only 0.3%. The same applies to positive results.

Development of litigation investment resolutions								
Underwriting Year	2009	2010	2011	2012	2013	2014	2015	Average
Number of investments	3	16	11	12	13	25	18	
Development Year								
0					4%	4%	0%	3%
1				29%	38%	22%		30%
2			50%	42%	58%			50%
3		56%	59%	58%				58%
4	100%	63%	73%					78%
5	100%	63%						81%

Source: Burford Capital, Hardman & Co

Note: Partial resolutions count as half.

The average is weighted by number of cases in underwriting year

The average duration of concluded investments fell slightly in 2015, but remains around two years. The table, equivalent to a run off triangle, give a more nuanced idea of how these progress over time. Given the recent large investment, it should be noted that investments make very little contribution in the year in which they are made.

Current book of business

Burford continued to grow its portfolio in 2015 with more than \$200m in new commitments across 18 investments. After allowing for exits and additions to existing investments the invested capital in its portfolio grew 15% to \$239m with a fair value of \$320m. In addition, contingent commitments grew from \$137m to \$213m, with the usual expectation that up to 50% will be paid out in the next year.

With the results Burford have announced a \$100m investment into a portfolio from a major law firm. This is fully funded from the outset and has no contingent commitments. We see this a significant step forward for Burford – the invested capital in litigation investment will have risen from 54% of equity at the end of 2014 to 77% now.

This has had a noticeable effect on Burford's balance sheet. At the end of 2015 cash and cash related investments totalled \$186m, with another \$31.2m due from litigation investments under current assets. This, of course, is supplemented by cash flow income from investments that conclude.

After the investment of \$100m Burford will still be able to meet its contingent commitments and continue to reinvest, but the balance sheet may be constrained if any other large opportunities appear. With a recent \$45m arrangement with a FTSE20 company as well as the latest transaction, the market does seem to be offering more of these and we believe Burford should have the capital available to take advantage of these. This fully justifies their intention to raise money through a retail bond issue.

Financials and Forecasts

Our estimates have been updated with upgrades of 13% to 2016E and 46% to the 2017E forecasts. The main factors that we have adjusted are as follows:

- ▶ As well as the additional \$100m investment we have increased our growth rate for additions to investments to 15%, reflecting the additional staffing.
- ▶ We have assumed greater cost growth in the litigation investment business, with 20% for 2016.
- ▶ Weaker sterling and Euro income.
- ▶ Insurance income will decline at a slower rate than the 20% per annum previously assumed.
- ▶ The terms for the retail bond have been announced with a 6.125% coupon for 8.5 years, but the amount to be raised is unknown. We have assumed Burford will raise £100m.

We also assume that the return on litigation investments returns to historic norms after an exceptional 2015, while noting as usual that the inherent volatility means this is an estimate of the mean expected return rather than a prediction of the actual results. In particular, if one of the outstanding 2010 cases is successful then upgrades will follow – our view is the revenue risks are asymmetric to the upside.

As we noted above, new investments tend to have little effect on earnings in the year in which they are made. So our 2016E estimates get a smaller upgrade due to bearing the costs of the retail bond, and not receiving much benefit from the additional \$100m investment. The latter, and the expected income growth that it brings, is the biggest factor influencing our 2017E upgrade.

Summary financials						
Year end Dec (\$m)	2012	2013	2014	2015	2016E	2017E
Revenue	54.2	60.7	82.0	103.0	101.3	138.1
Expenses	20.1	18.1	21.3	25.8	29.1	33.3
Operating Profit	34.1	42.5	60.7	77.2	72.2	104.8
Finance cost	0.0	0.0	3.7	9.3	15.9	18.0
Exceptional items	-14.2	-40.4	-9.7	0.0	0.0	0.0
Reported pre-tax	16.9	2.1	47.3	67.9	56.4	86.7
Reported taxation	0.4	0.5	-0.7	-2.2	-2.0	-2.7
Minorities	0.0	0.1	1.2	1.2	1.2	1.2
Underlying net income	31.6	40.1	53.0	64.5	53.2	82.9
Statutory net income	17.4	2.6	45.4	64.5	53.2	82.9
Underlying Basic EPS (p)	0.17	0.20	0.26	0.32	0.26	0.41
Statutory Basic EPS (p)	0.10	0.01	0.22	0.32	0.26	0.41
Dividend (\$)	0.05	0.05	0.07	0.08	0.09	0.10
Balance sheet						
Total equity	332.1	351.5	382.7	434.3	470.9	535.5
Invested Capital	142.1	173.6	207.0	239.0	430.3	499.6
Fair Value Balance	159.7	214.9	266.3	319.6	564.0	705.5
Total Assets	345.4	376.1	533.2	594.1	746.3	810.9
NAV Per share (\$)	1.62	1.72	1.87	2.12	2.30	2.62
Return on Equity	5.4%	0.8%	12.4%	16.1%	12.0%	16.7%

Source: Hardman & Co, £1=\$1.42

Valuation

The upgrade takes our 2017E eps estimate to €41 and return on equity estimate to 16.7%. Burford is continuing to invest in growing its capacity while at the same time it seems likely there will opportunities to make further large investments as well as ongoing growth in the smaller ones which have been its core until now. In short we expect Burford to continue growing beyond 2017.

Given the conservatism of the Burford management we expect that growth to be measured. The market opportunities are so big that they can manage very good growth rates while still being prudent.

In our last report we gave a valuation table which used RoEs up to 13%. The additional investment means we'd estimate that a RoE in the 15-17% range is sustainable, which gives the following based on our 2016E NAV per share of \$2.28.

2016 price targets under different assumptions						
Price (p)	CoE=9%			CoE=10%		
	growth			growth		
	3%	5%	7%	3%	5%	7%
14%	297	365	567	255	292	378
15%	324	405	648	278	324	432
16%	351	446	730	301	357	486
17%	378	486	811	324	389	540

Source: Hardman & Co

Being slightly conservative with an ROE of 15% and growth rate of 5% suggests a year end target of 323p. This would give a prospective PE of 11.3 times, which seems quite low for a business with such strong growth prospects. A 15% RoE with a dividend of around one third suggests a natural growth rate of around 10%, though we expect invested capital to grow at a faster rate for the next few years. Clearly Burford has strong upside if it continues to deliver as it did in 2015.

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