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BURFORD CAPITAL

Next $1.6bn of investments to boost returns

Burford has announced access to almost $1bn of new capital, which, combined with its balance sheet, gives a new and financially attractive structure for how the next $1.6bn of litigation finance investments will be made. The most significant part of this is a new strategic capital relationship with a sovereign wealth fund (SWF). The SWF and Burford have committed a $1bn pool of capital, with the former supplying $667m. Burford will supply the remaining one-third of the capital, but receive 60% of the investment profits. In addition, 50% of the new investments made will be allocated to the pool over the next four years, or until the pool is invested.

- **Burford Opportunities Fund (BOF):** Burford has also announced the raising of $300m of capital for a new private fund. The launch of this had been indicated previously, with the size being restricted due to the additional capital from the strategic partnership described above.

- **Capital requirements:** In addition to the pool, 25% of new litigation finance investments will be allocated to each of BOF and Burford's balance sheet. The net effect is that Burford will fund 42% of future litigation finance investments, but receive 60% of the investment returns.

- **Valuation:** Hardman & Co has made significant upgrades to its earnings estimates on Burford, with increased RoIC, lower invested capital growth and less debt issuance. The prospective 2019 P/E of 17.3x is not excessive for a growth company, with a 25.1% 2019E RoE giving strong metrics all round.

- **Risks:** The investment portfolio is very diversified, with exposure to more than 900 claims. However, it retains some very large investments, which means revenue could be volatile. As the company matures, we would expect that to decrease, but not to disappear. 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 grow, the litigation investment business will continue to produce strong earnings growth.

Financial summary and valuation

Year-end Dec ($m)	2015	2016	2017	2018E	2019E	2020E
Revenue	103.0	163.4	341.2	326.5	398.5	571.6
Operating profit	77.2	124.4	285.1	263.0	323.3	482.5
Reported net income	64.5	108.3	249.3	216.2	275.7	432.3
Underlying net income	64.5	114.2	264.8	227.9	287.4	444.0
Underlying RoE	16.0%	22.1%	35.9%	24.6%	25.1%	30.0%
Underlying EPS ($)	0.32	0.55	1.27	1.04	1.31	2.03
Statutory EPS ($)	0.32	0.53	1.20	1.03	1.26	1.98
DPS ($)	0.08	0.09	0.11	0.13	0.15	0.17
Dividend yield	0.4%	0.5%	0.6%	0.7%	0.8%	0.9%
NAV per share ($)	2.12	2.22	3.19	3.92	5.05	7.03
P/E (x) (underlying)	72.0	41.4	17.9	21.8	17.3	11.2
Price/NAV (x)	10.7	10.2	7.1	5.8	4.5	3.2

Source: Hardman & Co Research

Financials

Source: Eikon Thomson Reuters

Market data

EPIC/TKR	**BUR**
Price (p)	**1622.0**
12m High (p)	2040.0
12m Low (p)	1022.0
Shares (m)	218.6
Mkt Cap (£m)	3,545
Total assets ($m)	1,904
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
CFO	Elizabeth O'Connell
Chairman	Sir Peter Middleton

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

Key shareholders

Directors	8.2%
Invesco Perpetual	15.4%
Woodford Investments	9.5%
Old Mutual	5.0%

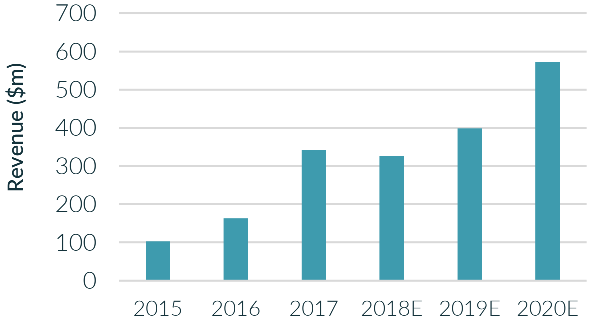
Diary

13 March	Full-year results

Analyst

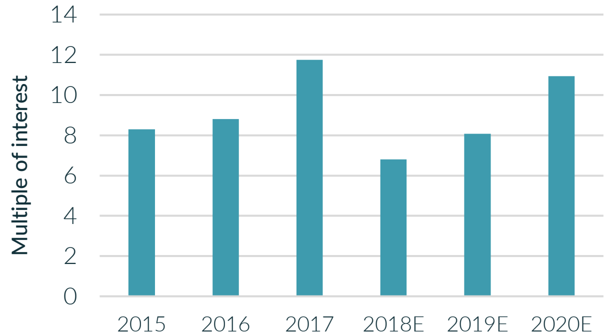
Brian Moretta 020 7194 7622
bm@hardmanandco.com

Revenue



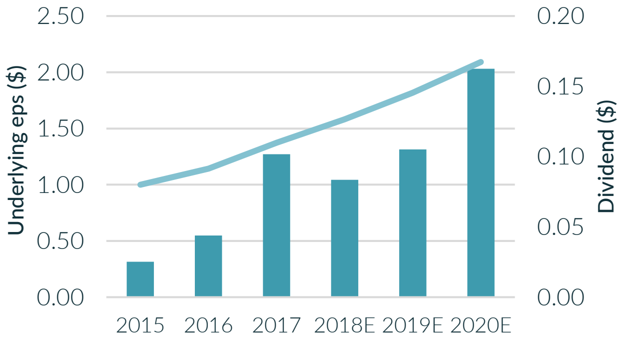
- Long-term growth depends on the pace of investment and conclusions
- Accelerated investment in 2017 will boost future revenues
- 2017 and 1H'18 figures were boosted by sales from the Petersen case and the results of the Teinver claim
- The investment management acquisition has added revenue from 2017 onwards

Interest cover (x)



- No debt prior to 2014
- Retail bond issues in 2014, 2016, 2017 and 2018
- Forecasts now assume no future bond issues in 2019 and only $100m in 2020
- Future cash needs and debt issuance are dependent on the rate of investment and the proceeds from realisations

EPS and DPS



- 2017 and 1H'18 results were boosted by sales from the Petersen case and the results of the Teinver claim
- Continued growth in the pace of investment is driving future returns
- Some large, single claims may continue to bring volatility in the future, although this is to the upside as well as the downside

Source: Company data, Hardman & Co Research

A new funding structure

At the time of the equity issue in October, Burford indicated that it was considering options for future fundraisings. With the Partners III fund being fully committed, the launch of a new fund with a similar mandate was expected. The arrangement that has been announced with the sovereign wealth fund (SWF) is more of a surprise.

Strategic capital relationship

The core of this is a new capital pool of $1bn, which will be invested on a 2:1 basis. The SWF will supply $667m of the capital, with Burford providing $333m of its own capital. The investment returns will be split 60% to Burford and 40% to the SWF. This applies to the returns from the outset, with no priority or capital returns first.

The arrangement appears to be somewhat unusual, with the SWF supplying two-thirds of the capital, yet only getting 40% of the return. It is worth noting that Burford is far from a passive deployer of capital and there is value in it applying its expertise. Some account of this is taken in the priority return of $7m to defray Burford's running costs.

If we use Burford's historical RoIC figure of 75% and average term of two years, we can estimate that, under this arrangement, the SWF would get an annualised return of around 22% p.a. Clearly, this is attractive relative to other assets, and gives a margin for volatility in returns and also allows scope for higher figures if investments turn out well. The lack of correlation with other assets is no doubt also attractive.

So, although the arrangement seems generous to Burford, it would also seem to have good prospects for giving the SWF a very attractive return. The current arrangement is simply for investing the announced pool, and returning the capital together with its returns to the SWF. However, the SWF has indicated that it is interested in further investments – so it seems likely that further capital will be invested or that the existing pool may be recycled.

The name of the SWF has not been disclosed.

It is worth noting that, unlike the funds, profits are allocated on a case-by-case, rather than a pooled, basis. This means that, when any individual investment concludes, Burford will receive its share of the return immediately, rather than waiting for the whole pool of capital to be returned to investors first.

Burford Opportunities Fund (BOF)

There are a couple of points worth noting about BOF:

- The investment of $5.6m from 40 employees is a significant vote of confidence.
- Fees, at 2% AMC plus 20% of profits subject to an 8% p.a. priority return to investors, are in line with expectations. As usual, there will be a return of the pool of investors' capital before Burford starts to receive its performance fee.

Capital allocation

The new arrangements apply to the normal litigation investments, and exclude complex strategies and asset recovery businesses. When Partners III was investing, new investments were allocated equally between Burford's balance sheet and the Partners III fund up to $15m, with everything above that going to the balance sheet.

Under the new arrangement, 50% will go to the pool with the SWF and 25% to each of BOF and Burford's balance sheet. The net effect is that Burford will supply 42%

of the capital for each investment, getting 60% of the returns. Of these, 5% is from performance fees, so the balance sheet return will be on 55% of the returns.

All other things being equal, this means Burford's return on its capital will be around 31% higher than it would have been previously (55%/42%). For example, if this had been in place historically, then Burford's RoIC would be 98%, instead of 75%.

The trade-off, all other things being equal, is that deployed capital is likely to grow more slowly. Crudely, if new investments are 42%-funded, rather than 50%-funded as previously, this represents 16% slower growth in invested capital. The effect of the cap on Partners III allocations is that more than 50% was allocated to the balance sheet, so the slowing will be a little higher.

With the growth in the profit rate being more than the slowing in invested capital, the net effect should be higher profits on investments, in both absolute and RoIC terms.

There is an additional saving for Burford, in that the new arrangement greatly reduces its need for further debt funding. Our previous forecasts assumed a total of $400m of debt issuance over the next two years. We are now assuming no debt raise in 2019 and only $100m in 2020, with the commensurate saving in interest costs.

The new arrangements are for the next $1.6bn of new capital deployed. Hardman & Co's 2018 estimate for new invested capital is $537m, with $705m of outstanding commitments. Assuming the latter is 50% invested in 2019, and our growth forecasts are correct, this suggests that the current arrangement will be in place through to late 2021. This indicates that Burford will start to talk about what arrangements will be made afterwards, in late 2020 or early 2021.

Estimate updates

As usual, we caveat our estimates with the comment that these are expected values of returns. The inherent uncertainty of when investments will mature and what they will earn in returns means distribution of potential earnings is far wider than our point estimates.

Below, we highlight our main adjustments to Hardman & Co estimates. As a new fund was already accounted for in investment management estimates, there has been no adjustment to this business line.

- Within litigation finance, we have increased the expected RoIC on new investments to 98%, or 49% a year. Existing investments are being left at the previous assumption of 38%, so there will be a blended return as new investments grow and existing ones mature.
- The growth rate for new invested capital has been reduced from 20% to 5%. While the new arrangement should not affect the company's ability to source investments, Burford's implicit confidence in its ability to deploy such large sums suggests ongoing growth.
- The final adjustment is for future debt raisings. Hardman & Co has removed the assumed raise in 2019 and reduced that for 2020 to $100m. While the existing arrangements should be able to fund the normal litigation investments through to 2021, Burford is always looking at new opportunities and may have additional requirements.

The net effect is significant upgrades to our earnings estimates, with underlying 2019E EPS increasing 13% to $1.31 and 2020E increasing 23% to $2.03.

Summary financials

Year-end Dec ($m)	2015	2016	2017	2018E	2019E	2020E
Revenue	103.0	163.4	341.2	326.5	398.5	571.6
Expenses	25.8	39.0	52.3	63.5	75.2	89.1
Operating profit	**77.2**	**124.4**	**285.1**	**263.0**	**323.3**	**482.5**
Finance cost	9.3	14.1	24.3	38.7	40.0	44.1
Exceptional items	0.0	-5.9	-3.8	0.0	0.0	0.0
Reported pre-tax profit	**67.9**	**104.1**	**249.2**	**212.6**	**271.5**	**426.7**
Reported taxation	-2.2	4.8	0.1	3.6	4.2	5.6
Minorities	1.2	0.6	0.0	0.0	0.0	0.0
Underlying net income	**64.5**	**114.2**	**264.8**	**227.9**	**287.4**	**444.0**
Statutory net income	64.5	108.3	249.3	216.2	275.7	432.3
Underlying basic EPS ($)	**0.32**	**0.55**	**1.27**	**1.04**	**1.31**	**2.03**
Statutory basic EPS ($)	0.32	0.53	1.20	1.03	1.26	1.98
DPS ($)	0.08	0.09	0.11	0.13	0.15	0.17
Balance sheet (@31 Dec)						
Total equity	433.1	462.2	664.5	856.9	1,104.8	1,537.1
Invested capital	252.9	394.3	631.4	876.8	1,172.0	1,356.6
Fair value balance	334.2	559.7	982.2	1,325.5	1,842.8	2,364.0
Total assets	**608.7**	**968.2**	**1,318.0**	**1,797.5**	**2,045.4**	**2,477.7**
NAV per share ($)	2.12	2.22	3.19	3.92	5.05	7.03
Underlying RoE	**16.0%**	**22.1%**	**35.9%**	**24.6%**	**25.1%**	**30.0%**

Source: Hardman & Co Research
£1=$1.30

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(Disclaimer Version 8 – Effective from August 2018)

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The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

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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research@hardmanandco.com

35 New Broad Street
London
EC2M 1NH

+44(0)20 7194 7622

www.hardmanandco.com