26 July 2018

HARDMAN & CO.
CORPORATE

# BURFORD CAPITAL

## No need to appeal these results

The 2018 interims yet again gave record figures, with the headline figures showing income and profits after tax both up 17%. The stand-out figure, however, was cash generation, which was boosted by the sale of the Teinver claim and came in at $299m. The main driver behind this growth remains the litigation finance business, which accounted for almost 95% of revenue. Revenue in this business rose by 21% and profit after tax by 23% to $185.4m. New business remained strong, with additions to investments up 19% on 1H'17, and total commitments increasing by 10%. Strong realisations offset some of this, and invested capital grew by 7% over the period.

- Other businesses: The other business lines suffered from revenue volatility. Asset management did not get a recurrence of performance fees. Both insurance and asset recovery are in a transition phase. Each has the promise of future growth, but is likely to continue to have some revenue volatility for now.
- Capital: Although cash generation was very strong, and Burford completed another bond raise, the company has indicated that it is looking at the best way to raise future funds. Partners III is fully invested, and the second half is usually stronger, suggesting balance sheet demands may be stronger in that period.
- Valuation: Hardman & Co has raised its 2018 EPS estimates but lowered them for 2019 and 2020. The prospective 2019 P/E of 22.6x is not excessive for a growth company, with a 21.6% RoE giving strong metrics all round.
- Risks: The investment portfolio is still diversified, with exposure to over 900 claims, but retains some very large investments, which means revenue may 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 ($m) | 2015 | 2016 | 2017 | 2018E | 2019E | 2020E |
|---|---|---|---|---|---|---|
| Revenue | 103.0 | 163.4 | 341.2 | 323.4 | 361.6 | 489.6 |
| Operating profit | 77.2 | 124.4 | 285.1 | 259.8 | 286.4 | 400.5 |
| Reported net income | 64.5 | 108.3 | 249.3 | 213.1 | 232.6 | 337.6 |
| Underlying net income | 64.5 | 114.2 | 264.8 | 224.8 | 244.3 | 349.3 |
| Underlying RoE | 16.0% | 22.1% | 35.9% | 24.2% | 21.6% | 25.1% |
| Underlying EPS ($) | 0.32 | 0.55 | 1.27 | 1.08 | 1.17 | 1.68 |
| Statutory EPS ($) | 0.32 | 0.53 | 1.20 | 1.02 | 1.12 | 1.62 |
| DPS ($) | 0.08 | 0.09 | 0.11 | 0.13 | 0.15 | 0.17 |
| Yield | 0.3% | 0.3% | 0.4% | 0.5% | 0.5% | 0.6% |
| NAV per share ($) | 2.12 | 2.22 | 3.19 | 4.10 | 5.09 | 6.71 |
| P/E (x) (underlying) | 84.2 | 48.4 | 20.9 | 24.6 | 22.6 | 15.8 |
| Price/NAV (x) | 12.5 | 12.0 | 8.3 | 6.5 | 5.2 | 4.0 |

*Source: Hardman & Co Research*

### Financials

*Source: Eikon Thomson Reuters*

### Market data

| | |
|---|---|
| EPIC/TKR | BUR |
| Price (p) | 1896.0 |
| 12m High (p) | 1896.0 |
| 12m Low (p) | 983.0 |
| Shares (m) | 208.2 |
| Mkt Cap (£m) | 3,419 |
| Total Assets ($m) | 1,653 |
| 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 |
| Chairman | Sir Peter Middleton |

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www.burfordcapital.com

### Key shareholders

| | |
|---|---|
| Directors | 10% |
| Invesco Perpetual | 17.8% |
| Woodford Investments | 10.0% |
| Old Mutual | 5.2% |

### Diary

| | |
|---|---|
| 5 December | Interim dividend payment |

### Analysts

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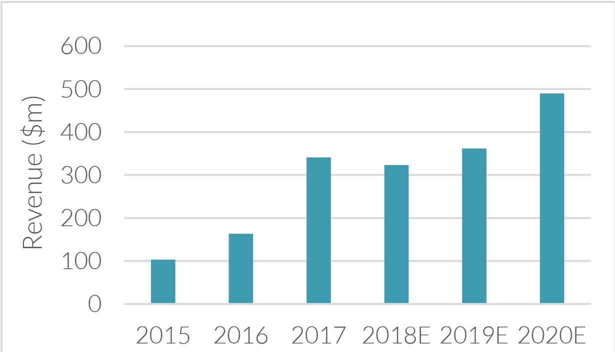
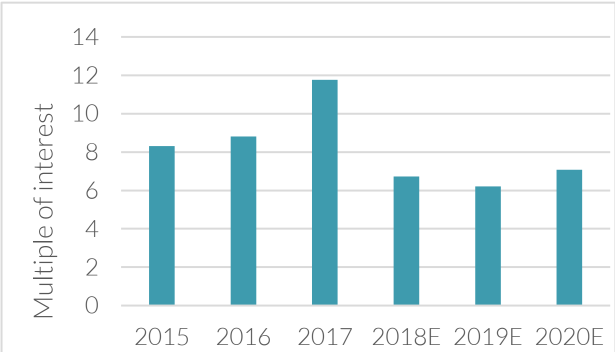
## Revenue



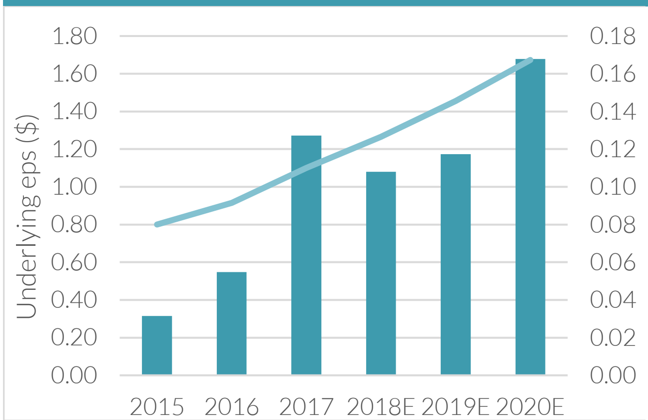

- Long-term growth depends on the pace of investment and conclusions
- Accelerated investment in 2017 will boost future revenues
- 2017 and 1H'18 figures were boosted by sales from the Petersen case and the results of the Teinver claim
- The investment management acquisition adds revenue from 2017 onwards

## Interest cover




- No debt prior to 2014
- Retail bond issues in 2014, 2016, 2017 and 2018
- Forecasts assume future bond issues in 2019 and 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*

# Interim results summary

Yet again, Burford has produced an outstanding set of interim results, with growth in income and profits confounding analysts, who had expected a decline in 2018.

Readers are reminded that the presentation in this report largely follows Burford's adjustments, removing the net effect of the third-party investment in the Complex Strategies Fund, rather than the IFRS figures. Not all the interim figures for 2017 follow this basis, and the difference is indicated where relevant.

The one difference is that the investment banking and brokerage fees are not treated as exceptional. It seems likely that these will be a regular part of Burford's business going forward, albeit the line is likely to be a volatile one depending on activity.

The headline figures, on an IFRS basis, show an increase in aggregate revenue of 17% to $205m and profit after tax by 21% to $161m. On an underlying basis, profit after tax rose 16% to $166m.

Burford also increased the interim dividend, from ¢3.05 to ¢3.67, an increase of 20%. Although the US Dollar/Sterling exchange rate has shown some volatility over the year, the rate is very similar to where it was a year ago, although any changes before payment may affect the effective growth rate to UK investors.

In the light of these figures, Hardman & Co has adjusted its earnings estimates. Our underlying 2018E EPS is now $1.08, an increase of 33%. The 2019E EPS decreases by 17% to $1.17 and the 2020E EPS by 16% to $1.68.

We note that our 2018E EPS, and now the 2019E EPS, are below the 2017 figures. The RoIC for 2017 was significantly above the long-term average, at 62% for the year. Our assumption of 37% (described in detail in our March 2018 report, entitled 'Outstanding results provide more positive evidence') corresponds to the cumulative average RoIC. Invested capital has continued to grow, but the net result is EPS estimates lower than 2017.

## Results by division

### *Litigation investment (litigation finance)*

Litigation finance

| $m | 2015 | 2016 | 2017 | 1H'18 |
|---|---|---|---|---|
| Income | 87.88 | 140.19 | 318.23 | 195.20 |
| Expenses | 15.65 | 26.02 | 33.54 | 13.07 |
| PBT | 72.22 | 114.17 | 284.69 | 182.13 |
| Tax | -2.23 | 4.72 | 2.41 | 3.24 |
| **PAT** | **70.00** | **118.89** | **287.11** | **185.37** |
| Op. margin | 82% | 81% | 89% | 93% |

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

As is now usual, this business continues to drive the growth in revenue and profits for Burford, accounting for almost 95% of revenue on an IFRS basis. Revenue grew 21% from 1H'17. Similar to those results, the revenue was dominated by realised gains, which accounted for 62% of income. For reference, the proportion in 2017 as a whole was 43%, so it can be seen that this proportion is volatile.

It seems likely that a significant proportion of this realised gain came from the Teinver and Petersen cases. The former saw a positive judgment in 2017 and was sold in early 2018 for $107m. The judgement will have been reflected in the year-end valuation, but the sale will have brought an additional gain. Two weeks ago, Burford announced the sale of another 3.75% of the Petersen case for $30m, which would have added to the gains.

Clearly, these are not the only investments to produce realised gains, and almost $75m of fair value movements also indicate reasonable activity in what is, usually, the weaker half of the year.

The sale of Teinver has generated a potential liability, with Burford retaining some residual risk as the purchaser can put the investment back to Burford under certain, unlikely, circumstances. Burford has recognised two put options in its accounts, one of which has now expired. Although Teinver is not specified, the amounts roughly correspond to that investment. The two options are valued at $9.25m in the accounts.

Expenses grew 23% over the 1H'17 figures. We note that the figure for the first half of the year is usually lower than the second, and we expect the margin to decline a little at the full year. As previously noted, Hardman & Co is positive on the continued expansion of the team, as it will help Burford to grow its investments.

## *Investment management*

Investment management

| $m | 2016 total | 2016 | 2017 | 1H'18 |
|---|---|---|---|---|
| Income | 15.40 | 0.65 | 15.63 | 7.19 |
| Expenses | 6.30 | 0.44 | 7.16 | 3.01 |
| PBT | 9.10 | 0.38 | 8.47 | 4.18 |
| Tax | | -0.08 | -3.01 | -0.11 |
| **PAT** | | 0.30 | 5.46 | 4.07 |

*Source: Burford Capital, Hardman & Co Research*

The first half of 2018 saw a small, 4.5%, revenue decline on the corresponding period last year. Although 1H'17 only saw a small amount of performance fees, these did not recur this year. A decline in expenses, however, meant earnings grew 12% to $4.07m.

There is some positive news on resolutions that should affect future profits. In Partners III, which is the most recent fund that follows the same investment strategy as Burford's on-balance sheet business, a trial win could lead to a gain of over $100m for investors and a performance fee in excess of $20m. The claim is still subject to appeal. The fund also has to return investor capital before performance fees can be paid. Although there has been other activity in the fund, given that the fund capital is over $400m, there will be a bit of time before performance fees are earned.

The Complex Strategies has also seen two resolutions that will earn Burford a mixture of fees and investment returns. These resolved after 30 June 2018 and so will be included in the full-year accounts.

The Partners III fund is now fully invested, although there is some limited scope for capital recycling. This is a year earlier than the permitted investment period. Burford expects to be marketing a new fund soon, with the natural option being a Partners IV fund, which will be similar to the preceding one.

## *Insurance*

| Insurance | | | | |
|---|---|---|---|---|
| $m | 2015 | 2016 | 2017 | 1H'18 |
| Income | 12.76 | 12.92 | 7.61 | 2.89 |
| Expenses | 2.58 | 1.70 | 2.00 | 0.94 |
| PBT | 10.19 | 11.23 | 5.61 | 1.95 |
| Tax | -1.19 | -1.61 | -0.66 | -0.27 |
| PAT | 9.00 | 9.62 | 4.95 | 1.68 |

*Source: Burford Capital, Hardman & Co Research*

The insurance business continues to see a decline in revenues as the residual business runs off. As it shrinks, volatility in the revenue appears to be increasing, accentuated by this being a sterling business, and the exchange rate continues to be volatile too.

Earlier this year, Burford announced that it was creating a new insurance business, targeting adverse claims of around £20m. The regulatory permissions for this are now in place, and the prospective policies are now being underwritten, although no premiums have been received yet.

Costs increased slightly, most likely reflecting activity in the new business that Burford is setting up. Insurance is now a business in transition. The legacy business is now small relative to the business as a whole. It will continue to generate profits for some time, albeit these seem likely to remain volatile and will decline over time. The new business is not intended to be high-volume. It too will be lumpy in revenues and profits, particularly in the early stages of its development. Although the insurance business will generate profits over time, Hardman & Co expects these to be small in the context of the business as a whole.

## *New initiatives*

| New initiatives | | | | |
|---|---|---|---|---|
| $m | 2015 | 2016 | 2017 | 1H'18 |
| Income | 2.51 | 8.85 | 2.97 | 1.00 |
| Expenses | 2.80 | 4.90 | 2.27 | 1.02 |
| PBT | -0.29 | 3.95 | 0.70 | -0.01 |
| Tax | 0.00 | -0.82 | -0.24 | -0.07 |
| PAT | -0.29 | 3.14 | 0.46 | -0.08 |

*Source: Burford Capital, Hardman & Co Research*

Asset recovery is also a business line that is in the middle of a transition, in this case from a for-fee business to a risk one, with a similar fee structure to Burford's main business. While revenues increased by a small amount, the most notable change was the growth in assets committed to this business. Commitments of $49m were made in the first half, with $18.5m of capital added on the balance sheet, bringing assets to $28.7m.

Given the small scale of operations relative to the main business, results seem likely to be volatile as the business builds up.

Burford has noted in the past that this is a useful business from a marketing perspective. One case this year has received significant press coverage, including on the front page of the *Wall Street Journal*.

### *Corporate*

Having issued another retail bond in February 2018, the interest costs for the debt rose to $18.9m.

Exchange rates were more complex in these results. Although sterling finished the half year lower relative to the dollar, the rate was higher for much of the period. The balance sheet adjustment was -$11.2m for the debt, but other comprehensive income saw a consolidation gain of $10.4m.

As part of a claim, Burford has exposure to approximately 6% of Jaguar Health, some of which is locked up. The share price declined over the reporting period, leading to a loss of $2.0m. Although accounted for separately, the ultimate realised value will be reflected through the litigation investments.

## Investments

### *New investments*

**Litigation investments**

| $m | 2015 | 2016 | 2017 | 1H'18 |
|---|---|---|---|---|
| Additions during period | 124.2 | 271.6 | 414.9 | 229.2 |
| Invested capital at year-end | 252.9 | 394.3 | 631.4 | 677.9 |
| Fair value at year-end | 334.2 | 559.7 | 982.2 | 1,101.9 |
| Fair value/invested capital | 132% | 142% | 156% | 163% |

*Source: Burford Capital, Hardman & Co Research*

Burford increased its commitments and investments compared with 1H'17. The rate of increase was slower than in previous years, although still healthy. Additions grew by 19% but, with realisations larger than usual, the invested capital grew only 7%.

Total commitments grew 10% to $540.3m. Strong growth in single case and portfolio finance was offset, to some extent, by recourse finance and legal risk management being slower. Some of the latter reflects the newer nature of these lines. The growth in asset recovery has been noted above.

Contingent commitments as a whole rose from $566m to $595m, with asset recovery accounting for almost the entire increase. Legal risk exposure rose slightly from $61.1m to $63.7m. Some of this latter business line will be replaced by the new insurance business going forward, and this amount may start to decline in the future.

### *Added information on investments*

Although Burford does not supply as much information with its interim report as it does at the full year, there are some interesting details included in the latest announcement.

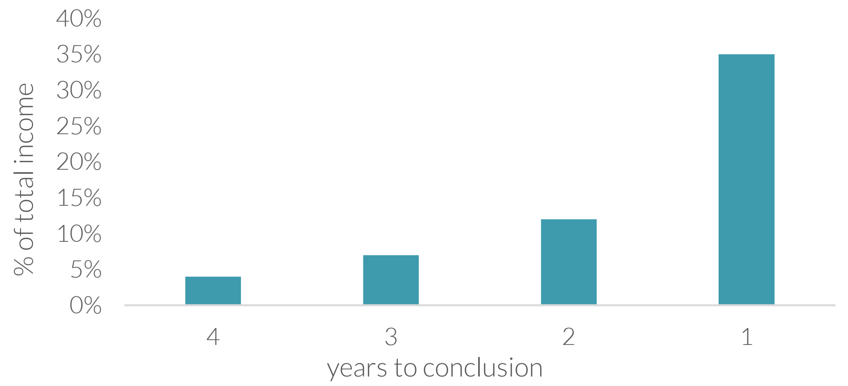
Rather than reiterate all the points, we present some highlights below:

- Diversification: At 30 June 2018, Burford had 89 investments with over 900 underlying claims. While the size of these varies, no defendant is more than 5% of the total commitments and no single claim is worth more than 3%. The latter is an increase from 2% at the year-end, suggesting ongoing investment in a larger claim.
- Law firms: Burford is working with over 50 law firms, with the largest relationship involving 13% of investments. This is spread across more than 30 partners in the firm, suggesting that, even here, the risk may not be that concentrated.

- **Business development**: Burford has previously indicated that it takes on single case investments to help develop relationships with law firms. It has quantified how successful this is, indicating that 75% of law firms that have a single case funded by Burford subsequently bring further investment opportunities, with 40% of these portfolio opportunities.
- **Scale**: Burford is the largest direct investor and investment fund manager in the legal sector.

Burford has also supplied information on the timing valuation changes relative to conclusion.

Timing and quantum of cumulative valuation changes in concluded portfolio




*Source: Burford Capital*

This suggests that Burford is not anticipating much of its income in its fair value movements. It is worth making two observations about this graph.

- The first is that the average duration to end-2017 was less than two years. Those settling in the first year or two are most likely settlements at relatively early stages, so are unlikely to have made much progress through the litigation process that can be reflected in valuations.
- The second is that, as at end-2017, Burford's historical RoIC was 75%, while its current fair value/invested capital is 162%. This latter figure is clearly influenced by the Petersen case. We do not know the up-to-date capital committed or valuation, but even conservative estimates reduce the ratio quickly.

## Balance sheet

From a balance sheet perspective, the first half was relatively quiet, with the main change being the issue of Burford's fourth retail bond. It was Burford's, and ORB's, first US Dollar-denominated issue, and it raised $180m, or $177m net of expenses.

| Key balance sheet figures | | | | |
|---|---|---|---|---|
| $m | 2015 | 2016 | 2017 | 1H'18 |
| Litigation investments (FV) | 334.2 | 559.7 | 982.2 | 1101.9 |
| Cash investments & equiv. | 185.6 | 169.5 | 131.4 | 288.3 |
| Due from litigation investments | 61.61 | 40.12 | 4.77 | 40.65 |
| Goodwill & intangible assets | | 173.33 | 161.71 | 156.94 |
| **Total assets** | 608.7 | 968.2 | 1318.0 | 1653.2 |
| Debt | 131.3 | 274.0 | 486.9 | 653.8 |
| Shareholders' equity | 434.2 | 596.2 | 798.6 | 953.7 |
| Net gearing | -13% | 18% | 45% | 38% |
| Gross gearing | 30% | 46% | 61% | 69% |

*Source: Burford Capital, Hardman & Co Research*

Burford has again supplied a waterfall graph in its presentation showing the sources and applications of cash. Cash generation from the business this year was a very strong $299m, aided by the sales of the Teinver and Petersen cases, which, together, accounted for almost 46% of the total.

Amounts due from litigation investments returned to more normal levels after the low at the year-end.

Assessing Burford's future cash requirements is as much of an art as a science. The cash balances as of 30 June were $288m. Investment deployments were $244m in the first half. This probably understates the expected deployment in the second half for two reasons:

- there is some seasonality, with the second half of the year usually being more active;
- Partners III Is effectively fully invested, so more of the new business flow will go onto the balance sheet.

Realisations will continue to bring cash in, although the rate of the first half was exceptionally high. A rate in line with our profit expectations, and allowing for growth and the factors above would suggest the year-end cash balance could be lower than at the start of the year.

Given the above, it is not surprising that Burford has indicated that it is looking at its capital structure. Fortunately, Burford does seem to have some options. It has indicated that it will look at raising another fund. The balance sheet growth also gives it capacity for further debt.

Neither option is perfect. While a fund does not require significant capital, the structure defers performance fees relative to investing on the balance sheet, and investors capture much of the return. Debt brings the drag of surplus cash on the balance sheet. It is also unclear whether the retail bond market has the capacity to fund larger bond issues, although, given its track record, other options may now be available at a sensible cost.

That said, Burford has options and the benefit of being in a good position financially, which gives it scope to consider and balance the best interest of shareholders. It does seem likely that there will be further news on this later this year.

# Financials and forecasts

As we always note for Burford, the uncertainty of when claims will settle, and for how much, makes the life of a forecaster challenging. To this, we should add the accelerating pace of investment. Yet again, we are making significant revisions to our forecasts. We list below the major areas that we have adjusted, and outline the reasoning. Our core modelling of returns remains based on the invested capital and the *expected* return on that. The aim is to be right, on average, with the acknowledgement that the variation in any given year is unpredictable and has the potential to make our forecasts look foolish.

We also remind readers that these forecasts are for the underlying Burford business. Burford has committed to disclosing this on an ongoing basis, and differences from the IFRS seem likely to remain for the foreseeable future.

► For the first time since we started covering Burford, the level of investment in a reporting period was a little behind our expectation. With invested capital growing only 7%, this reduces expected revenue in the forecast period. We have left our growth assumptions unchanged, as we were already forecasting a slowing in future years.

► Our 2018 forecasts are updated to allow for the first-half figures, the second half of the year using the same assumptions as before.

► The insurance and asset recovery businesses have seen small downgrades, reflecting the volatility, although the future growth rates in the latter are unchanged.

► Asset management had only a small increase in performance fees forecast, and the estimates have been left unchanged.

► Central expenses were lower than expected, and the growth rate has been reduced accordingly.

► Further bond issues are still assumed in 2019 and 2020, although the amount of each has been increased to $200m.

The first two items, together with the last one, have made the most difference.

The net effect is a significant increase to our 2018 estimates, but a reduction to our 2019 and 2020 estimates. Our underlying 2018E EPS goes from $0.81 to $1.08, an increase of 33%, but our 2019E EPS reduces by 17% to $1.17 and 2020E EPS by 16% to $1.68.

We note that our 2018E EPS, and now our 2019E EPS, remain below the 2017 figures. The RoIC for 2017 was significantly above the long-term average, at 62% for the year. Our assumption of 37% corresponds to the cumulative average RoIC. Invested capital has grown, but the net result is an EPS estimate lower than 2017. For 2019, the forecasts give growth in revenue and operating profit relative to 2017, but the cost of the additional debt brings the EPS estimate below the 2017 figure.

The inherent uncertainty does mean that investors may disagree with our assumptions or wish to see the effect that changing them may bring. To this end, we give a simple sensitivity analysis. This introduces three alternative scenarios:

- an increase in the RoIC on investments to 90% for all future years, i.e. 45% p.a.;
- a decrease in the RoIC on investments to 60% for all future years, i.e. 30% p.a.;
- a doubling of the rate of growth in additions to invested capital in 2H'18 from 25% to 50% and in 2019 from 20% to 40%.

### Sensitivity analysis

| $ | 2017 | 2018E | 2019E | 2020E |
|---|---|---|---|---|
| Underlying EPS | 1.27 | 1.08 | 1.17 | 1.68 |
| RoIC at 90% | | | | |
| Underlying EPS | | 1.20 | 1.51 | 2.13 |
| Change | | 11% | 29% | 27% |
| RoIC at 60% | | | | |
| Underlying EPS | | 0.97 | 0.88 | 1.27 |
| Change | | -10% | -25% | -24% |
| 2H'18 & 2019 IC growth doubled | | | | |
| Underlying EPS | | 1.08 | 1.23 | 1.90 |
| Change | | 0% | 5% | 13% |

*Source: Burford Capital, Hardman & Co Research*

### Summary financials

| Year-end Dec ($m) | 2015 | 2016 | 2017 | 2018E | 2019E | 2020E |
|---|---|---|---|---|---|---|
| Revenue | 103.0 | 163.4 | 341.2 | 323.4 | 361.6 | 489.6 |
| Expenses | 25.8 | 39.0 | 52.3 | 63.5 | 75.2 | 89.1 |
| Operating profit | 77.2 | 124.4 | 285.1 | 259.8 | 286.4 | 400.5 |
| Finance cost | 9.3 | 14.1 | 24.3 | 38.7 | 46.2 | 56.6 |
| Exceptional items | 0.0 | -5.9 | -3.8 | 0.0 | 0.0 | 0.0 |
| Reported pre-tax | 67.9 | 104.1 | 249.2 | 209.5 | 228.5 | 332.2 |
| Reported taxation | -2.2 | 4.8 | 0.1 | 3.6 | 4.1 | 5.4 |
| Minorities | 1.2 | 0.6 | 0.0 | 0.0 | 0.0 | 0.0 |
| Underlying net income | 64.5 | 114.2 | 264.8 | 224.8 | 244.3 | 349.3 |
| Statutory net income | 64.5 | 108.3 | 249.3 | 213.1 | 232.6 | 337.6 |
| Underlying basic EPS ($) | 0.32 | 0.55 | 1.27 | 1.08 | 1.17 | 1.68 |
| Statutory basic EPS ($) | 0.32 | 0.53 | 1.20 | 1.02 | 1.12 | 1.62 |
| DPS ($) | 0.08 | 0.09 | 0.11 | 0.13 | 0.15 | 0.17 |
| | | | | | | |
| Balance sheet | | | | | | |
| Total equity less goodwill | 433.1 | 462.2 | 664.5 | 853.7 | 1,058.9 | 1,396.5 |
| Invested capital | 252.9 | 394.3 | 631.4 | 876.8 | 1,211.0 | 1,549.4 |
| Fair value balance | 334.2 | 559.7 | 982.2 | 1,322.4 | 1,842.1 | 2,435.2 |
| Total assets | 608.7 | 968.2 | 1,318.0 | 1,797.9 | 2,203.1 | 2,540.7 |
| | | | | | | |
| NAV per share ($) | 2.12 | 2.22 | 3.19 | 4.10 | 5.09 | 6.71 |
| Underlying RoE | 16.0% | 22.1% | 35.9% | 24.2% | 21.6% | 25.1% |

*Source: Hardman & Co; £1=$1.31.*

# Notes

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