16th March 2018

hardman&co

Financials

Source: Thomson Reuters Eikon

Market data

EPIC/TKR	**BUR**
Price (p)	1376.0
12m High (p)	1428.0
12m Low (p)	732.0
Shares (m)	208.2
Mkt Cap (£m)	2,865
Total assets ($m)	1,318
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	14%
Invesco Perpetual	19.8%
Woodford Investments	10.0%
Old Mutual	6.0%

Next event

22nd May 18	AGM
22nd Jun 18	Final dividend paid

Analyst

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Burford Capital

Outstanding results provide more positive evidence

Burford has produced another stunning set of results for 2017. Revenue grew 109% to $341.2m, with 20 investments providing realised gains. Profit after tax grew 129% to $249.3m, with the underlying figure up 132% to $264.8m. RoE was a very impressive 37%. The aggregate RoIC has grown to 75%, with total resolutions since Burford's inception now $773m. Equally as impressive is the continued acceleration in the pace of investment, with $698m of new commitments in the year. It is clear that Burford is not just delivering today, but its continuing investment should ensure that it can continue to deliver in the future too.

- **Dividend:** A final dividend of 7.95¢ was announced, bringing the total for the year up to 11.0¢. This is a 20% increase on 2016. Burford continues to balance the desire of some shareholders to have an income against its ability to deploy capital and deliver outstanding returns.

- **Continued expansion:** As well as continuing to invest in its core business, Burford is expanding its other operations. It has set up a new insurance operation for large adverse claim costs, for which it is in the process of seeking authorisation. We expect a raising for a new fund to begin at some point too.

- **Valuation:** We have raised our forecasts significantly, with our underlying 2019E EPS increasing by 78% to $1.41. Even after a large price move on the day of the results, the prospective P/E for 2019 is now 13.7x, which compares favourably with other companies with a similar growth profile.

- **Risks:** The investment portfolio is still diversified, with exposure to over 800 claims, but it 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 Teinver case shows that this volatility is not simply a negative.

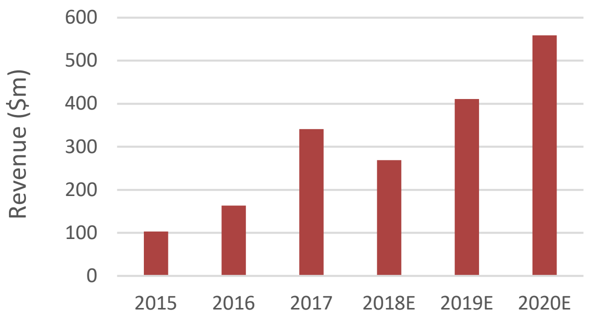
- **Investment summary:** Burford keeps demonstrating an impressive ability to deliver very good returns in a growing market while investing its capital base. As the invested capital continues to grow, the litigation investment business should continue to produce strong medium-term earnings growth.

Financial summary and valuation

Year-end Dec ($m)	2015	2016	2017	2018E	2019E	2020E
Revenue	103.0	163.4	341.2	268.8	410.9	558.7
Operating profit	77.2	124.4	285.1	204.7	335.0	468.9
Reported net income	64.5	108.3	249.3	157.3	281.4	406.4
Underlying net income	64.5	114.2	264.8	169.0	293.2	418.1
Underlying ROE	16.0%	22.1%	35.9%	18.5%	26.9%	29.6%
Underlying EPS ($)	0.32	0.55	1.27	0.81	1.41	2.01
Statutory EPS ($)	0.32	0.53	1.20	0.76	1.35	1.95
DPS ($)	0.08	0.09	0.11	0.13	0.15	0.17
Yield	0.4%	0.5%	0.6%	0.7%	0.8%	0.9%
NAV per share ($)	2.12	2.22	3.19	3.83	5.05	7.00
P/E (x) (underlying)	61.1	35.1	15.1	23.7	13.7	9.6
Price/NAV (x)	9.1	8.7	6.0	5.0	3.8	2.8

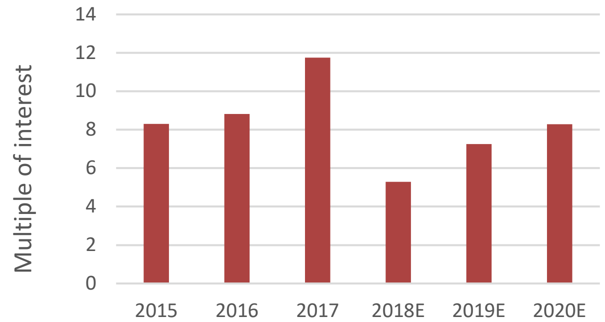
Source: Hardman & Co Research

Revenue



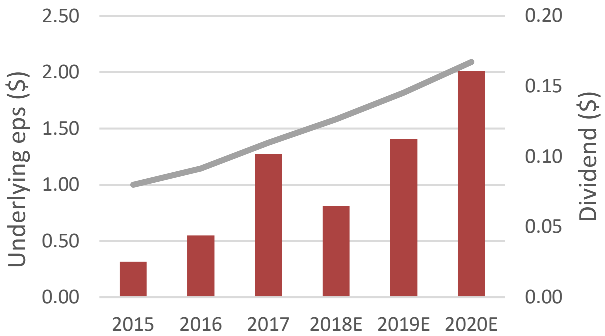
- Long-term growth depends on the pace of investment and conclusions
- Accelerated investment in 2017 will boost future revenues
- 2017 figures were boosted by sales from the Petersen case and the result of the Teinver claim
- The investment management acquisition adds revenue from 2017 onwards

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 results were boosted by sales from the Petersen case and results of the Teinver case
- A continued acceleration 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

Results summary

Although Burford produced a steady flow of positive news in 2017, almost all leading to upgrades, it still managed to produce an exceptional set of results for the full year. However, a small accounting explanation is required. As the new Complex Strategies Fund is deemed to be under Burford's control, it is accounted for on a consolidated basis. Over half of the capital in this fund is supplied by third-party investors, and Burford has produced figures that separate this from its own balance sheet. This report is consistent with the latter, which is what shareholders have exposure to.

This means that the figures used in this report do not match the IFRS ones. For the profit and loss account, this difference is minor, with more substantial differences on the balance sheet. Burford has reconciled this for the company, but we have had to make a couple of assumptions in the presentation of the results by division.

Aggregate revenue jumped by 109% to $341m, with profits after tax growing 129% to $249m. On an underlying basis (excluding amortisation and one-offs), the growth was an even better 132%.

The final dividend was increased to 7.95¢, giving a full-year figure of 11.0¢, which is a 20% increase on the previous year. With sterling having strengthened recently, UK investors will probably see a smaller rate of growth.

In the light of these figures, Hardman & Co have substantially upgraded our earnings estimates. Our underlying 2018E EPS is now $0.81, an increase of 40%, and 2019E EPS increases by 78% to $1.41. We also introduce a 2020E EPS of $2.01.

We note that our 2018E EPS remains below the 2017 figures. The RoIC for 2017 was significantly above the long-term average, at 62% for the year. Our increased assumption of 37% (described in *Financials and forecasts* on page 10) corresponds to the cumulative average RoIC. Invested capital has grown significantly, but the net result is an EPS estimate lower than 2017.

Results by division

Litigation investment (litigation finance)

Litigation finance

$m	2014	2015	2016	2017
Income	47.85	87.88	140.19	318.23
Expenses	10.42	15.65	26.02	33.54
PBT	37.43	72.22	114.17	284.69
Tax	0.61	-2.23	4.72	2.41
PAT	**38.04**	**70.00**	**118.89**	**287.11**
Op. margin	78%	82%	81%	89%

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

This business continues to be the main driver behind the growth in revenue and profits for Burford. Although the Petersen and Teinver cases have caught the headlines, and are probably the largest individual contributors to the income line, 20 different investments provided realised gains in 2017. Both the named cases have been discussed in previous notes, and we do not go into the details here (although we note below that the Teinver case has been sold in the secondary market – and we go into more on this further down in the report).

Since Burford made its sales, there has been subsequent secondary market activity in the Petersen case. The sales have taken place at various prices, with a weighted average implied valuation for the whole investment in 2017 of $660m. This compares with $440m for the last sale that Burford made. The valuation that Burford has used remains conservative, on the basis that the size of sales was not sufficient to establish a sale price for the whole investment. At the half year, the valuation was set well below the $440m from the original transactions. The increased secondary market price has led to a further uplift, but with the net unrealised increase across all investments of $181m it can be seen that the carrying value remains well below the trading level.

Costs again grew significantly over 2016, at 29%. Much of this reflects the first full year of the staff brought in with the Gerchen Keller acquisition. We noted in the report on last year's results (20 March 2017) how the management had grown its staff capacity. Given the rate of growth in revenues and investments, the growth in capacity is bringing results, and we would encourage the management to continue to invest in staff and capacity.

Burford occasionally receives compensation in the form of assets, rather than cash. In 2017, it received approximately 6% of the equity in Jaguar Health, a NASDAQ listed company, some of which is locked up. The price of this is very volatile. At the year end the price was $0.14 per share, significantly lower than the price at which the shares were received. The value as of the year-end was $6.1m, with an unrealised loss of $7.0m. Since then the price has recovered, closing at $0.214 on 14th March 2018, which would add $3.2m to the value. Under IFRS, this is accounted for separately but, given the lock-up, it will affect the ultimate value of the relevant investment.

Investment management

Investment management

$m	2016 Total	2016	2017
Income	15.40	0.65	15.63
Expenses	6.30	0.44	7.16
PBT	9.10	0.38	8.47
Tax		-0.08	-3.01
PAT		**0.30**	**5.46**

Source: Burford Capital, Hardman & Co Research

The 2017 results were the first with a full year for the investment management business. For 2016, the figures given are the total for the year, most of which was pre-acquisition, and the small amount that was included in the 2016 accounts.

Revenues for the year only showed small growth over 2016. The first performance fees, $2.7m, were earned. The management fees showed a decline, with the maturing of the Partners I and II Funds meaning that fees from them are no longer earned on some investments. Burford notes that there is an investment in Partners I that is at appeal, for which the current award would earn a $5m performance fee. This would exceed the aggregate management fees paid on the fund.

Partners III is now almost fully invested, at $334m of the $412m initially committed. Apart from the increased management fees, it would suggest that a Partners IV Fund would be an obvious option for the next fund that Burford could launch.

There has been a decline in capital committed to the Credit Opportunities Fund. The total is now at $296.1m, down from $416m at the time of acquisition. No performance fees were earned on this.

As previously announced, the Complex Strategies Fund raised $500m in 2017, of which $320m was deployed by the year-end. With increased deployment and a full year of fees, this should contribute increased management fees in 2018.

Insurance

Insurance

$m	**2014**	**2015**	**2016**	**2017**
Income	24.34	12.76	12.92	7.61
Expenses	5.40	2.58	1.70	2.00
PBT	18.94	10.19	11.23	5.61
Tax	-3.86	-1.19	-1.61	-0.66
PAT	**15.08**	**9.00**	**9.62**	**4.95**

Source: Burford Capital, Hardman & Co Research

With the legacy insurance business in run-off, the expectation has been that this business will decline over time. Although 2016 gave a better-than-expected result, 2017 saw a resumption of the decline. Currency movements have been a significant influence on this, with exchange rate making this decline look more volatile than the underlying figures would imply.

Burford announced last week that it was looking to open a new insurance business. The previous operation was in what Burford called ‘middle market’, dealing with adverse cost risk of up to around £3m. Burford believes it has identified a gap in the market for larger claims, of around £20m. It has started a new insurance company to write this business, which is currently awaiting regulatory approval. Once this is received, Burford will be able to start underwriting immediately.

The anticipation is that this will be a low-volume, high-value business compared with the previous business. This means that the premiums and claims are likely to be rather lumpy, particularly in the early years. We note that Burford has reinsurance in place, so this may help smooth out the results.

Given this news, it is perhaps not surprising that costs have risen for insurance. Although we would expect that those for the legacy business will continue to decline, there will be costs associated with putting the new business in place.

Looking forward, there will be two businesses with opposite trends: the legacy business in run-off and the new, wholly owned business, which will start underwriting. The latter will be on Burford’s balance sheet, in contrast to the former arrangement, which used Munich Re’s. The latter has a $12m asset, which is still being held in case of adverse claims, but otherwise should be returned to Burford at some point.

New initiatives

New initiatives				
$m	**2014**	**2015**	**2016**	**2017**
Income	0.22	2.51	8.85	2.97
Expenses	1.56	2.80	4.90	2.27
PBT	-1.34	-0.29	3.95	0.70
Tax	0.47	0.00	-0.82	-0.24
PAT	**-0.87**	**-0.29**	**3.14**	**0.46**

Source: Burford Capital, Hardman & Co Research

The results from the asset recovery business suffered in 2017 from a repositioning. The business had been run on a for-fee basis, but Burford believes it can be more profitable using contingent arrangements. The switch to this has been implemented, but the short-term effect has been to slow the accrual of fees, while the contingent arrangements have not started to pay off yet. The balance sheet has $10.2m of assets, from $2.3m a year previously, suggesting that the business has grown its potential, even if the financial benefits are yet to be seen. As an immature business, we expect the revenue line to be volatile over the next couple of years.

Burford does note that this business is a very useful part of its marketing, giving comfort to clients who are potentially worried about actually getting their awards paid.

Corporate

Having issued another retail bond in 2017, the interest costs for the debt rose to $24.5m. With the recent issue of Burford’s fourth retail bond, this will rise again in 2018.

With sterling strengthening over 2017, there was a negative adjustment in the value of the retail bonds of $28.2m. With the recent issue being dollar-denominated, there will be no change in sensitivity in absolute terms, but with the growth in the balance sheet, the relative exposure will be less.

The recent changes in US corporate tax rates have led Burford to change its medium-term guidance, with the overall tax rate expected to settle in the low teens, rather than the high teens previously suggested.

Investments

The investment business remains the core of Burford’s finances. While much has been written on individual investments, what matters to shareholders is the portfolio as a whole. The 2017 results were very good on several dimensions, with Burford supplying some additional information on its portfolio and investment approach, which should help to enhance investors’ understanding.

Since the year-end, Burford has sold its interest in the Teinver case. It received $107m, a superb gain on a $12.8m investment, giving a 736% Return on Invested Capital (RoIC). There is a very small amount of residual risk, as the buyer has an option to put the investment back to Burford under unlikely circumstances. With probably another couple of years before the legal process will complete, possible further delays with collection and a low interest rate in deferment, taking a discount to resolve this looks very reasonable for Burford. The sale price is ahead of the year-end valuation, meaning that a further gain will be booked in 2018.

Cumulative returns					
	2013	**2014**	**2015**	**2016**	**2017**
RoIC	62%	60%	70%	60%	75%
IRR	26%	24%	28%	27%	31%

Source: Burford Capital, Hardman & Co Research

Statistically, Burford's results were huge relative to what it has achieved before. Realisations of $313.5m gave realised gains of $135.7m. The latter is not only 2.8 times the previous year, but also more than the total realised gains in the preceding four years. While the Petersen sales are a significant part of this, there were 20 different investments that contributed to this figure.

Given the strength of these, it is perhaps no surprise that Burford's RoIC and IRR figures have improved. The cumulative RoIC is now 75%, with $773m of realised investments. Although Teinver was after the year-end, we note that it would have pushed the RoIC over 90%. Given that this claim has been running since 2010, the effect on the IRR is likely to be less dramatic.

The weighted average duration on concluded investments declined again in 2017, from 1.6 years to 1.5 years. Burford believes the long-run average remains two years, and we note that Teinver was open for almost eight years.

The fair value gain was $181.2m, a larger figure than the total of all Burford's historical movements. The aggregate gain is now 156% of the invested capital. It should be noted that both the Petersen and Teinver investments are included. While we do not know the valuation of these, they are large investments that have a significantly higher ratio. This reassures us that that, for the balance of the portfolio, the anticipated gain is not being overestimated.

New investments

Litigation investments				
$m	**2014**	**2015**	**2016**	**2017**
Additions during year	77.4	124.2	271.6	414.9
Invested capital at y/e	207.5	252.9	394.3	631.4
Fair value at y/e	266.8	334.2	559.7	982.2
Fair value/invested capital	129%	132%	142%	156%

Source: Burford Capital, Hardman & Co Research

The ongoing sourcing of new investments is as important to shareholders as the achieved results. In 2017, Burford managed another record year. Aggregate commitments of $1.34bn had already been announced, with almost half being investment fund commitments. Although Burford is looking to grow business that does not require the investment of capital, future returns are primarily a function of the capital invested.

The $414.9m of additions represents 53% more than the previous year, with the year-end invested capital 60.1% higher. Contingent commitments jumped from $297m to $564m. Clearly, Burford continues to build its portfolio to underpin its future growth.

Added information on investments

Burford usually gives a detailed additional commentary to supplement its numbers. This year saw even greater depth. Rather than reiterate all the points, we present some highlights below:

- **Diversification:** At the year-end, Burford had 82 investments with 877 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 2%. The portfolio can be considered to be very diversified.
- **New business selection:** In 2017, Burford closed on 59 investments out of the 1,561 requests for business that it received. The company's selectivity remains as strict as ever, despite the growth in size.
- **New business mix:** Single-claim investments were 5% of new business, with portfolio and recourse investments now 95%. The portfolio as a whole still has more single-claim exposure, but this will continue to reduce over time. The average commitment size has also grown to $24m, from $18m in 2016.
- **Valuations:** Only 0.2% of write-ups have ever turned into a loss.
- **Marketplace:** The market as whole continues to grow, and there is competition for Burford. Burford believes that none of its competitors are as well placed as Burford is, and the untapped potential in the market still appears to be much larger than the current business being written.

Balance sheet

In 2016, there were several items that affected the balance sheet, but were not operational issues. Last year proved to be simpler, with the main change being the issue of Burford's third retail bond. It raised £175m.

Key balance sheet figures

$m	2014	2015	2016	2017
Litigation investments (FV)	266.3	334.2	559.7	982.2
Cash investments & equiv.	189.6	185.6	169.5	131.4
Due from litigation investments	63.51	61.61	40.12	4.77
Goodwill & intangible assets			173.33	161.71
Total assets	533.2	608.7	968.2	1318.0
Debt	138.1	131.3	274.0	486.9
Shareholders' equity	382.7	434.2	596.2	798.6
Net gearing	0%	-13%	18%	45%
Gross gearing	36%	30%	46%	61%

Source: Burford Capital, Hardman & Co Research

The most notable figure is the reduction in the due from litigation investments figure, which has dropped to under $5m. Burford is rightly proud of this, but we note that this is unlikely to improve further and is likely to be higher in the future.

In its presentation (page 17), Burford presented a useful waterfall graph showing the principal sources and uses of cash in 2017. During the year, its cash requirement was $631m, of which $102m related to the GKC transaction and another $10m of non-recurring costs. The cash generated from operations was $362m, giving a net gap of $157m. With $224m raised in a bond offering and $169m in cash at the start of the year, this was not a problem.

Since the year-end, there has been a further bond issue, with a $180m issue being the first euro-dollar issue on ORB. There will also be the cash receipt of $107m from the Teinver sale. Added to the cash on the balance sheet, Burford is well placed to continue to fund its growth for now.

Given the rate at which it continues to grow its investment rate, it seems likely that further capital will be required, but Hardman & Co expects that to be in 2019. The usual caveat is that the timing also continues to be dependent on future realisations. A favourable resolution on Petersen or another large case could bring a significant amount of cash onto the balance sheet, offsetting the potential requirement for further external funding.

Plc matters

The last year has seen some staffing changes and a review of Burford's capital structure. The staffing changes have largely been covered elsewhere, but Burford did highlight in this report the diversity of its senior management. More than a third of senior positions are filled by women.

A former adviser to Burford conducted a review of Burford's capital structure in 2017. Although the recommendations were broadly of no change, it is perhaps worth noting a couple of the points:

- No benefit seen from moving from AIM to Main Market.
- No benefit from listing in the US, either directly or using an ADR.
- Further capital raisings most likely better through debt of the investment funds, rather than equity.

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 also 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 both unpredictable and has the potential to make our forecasts look foolish.

We also remind readers that these 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.

- ► The level of investment was well ahead of our expectations. With higher invested capital, we expect higher revenue. We have also slightly increased our growth assumption.
- ► We have been assuming an average 64% RoIC for investments over two years. We have increased that to 74%, still over two years. If we add the Teinver sale to the known figures, the historical figure is significantly higher but other realisations will also have to be taken into account. Overall, as the weight of evidence grows, an assumption more in line with the long-run average seems the most sensible option.
- ► As well as the new bond issued in February 2018, we are assuming further bond issues in both 2019 and 2020, with finance costs rising accordingly.

These three items have had the largest effect on our estimates. We have made smaller changes in the other divisions:

- ► For investment management, we have continued to assume steady growth in assets and performance fees. The former seems reasonable, but we note the latter are likely to be volatile.
- ► In insurance, we have assumed that the aggregate business remains flat, with the new business offsetting the decline in residual. This seems conservative, but until it starts, it is hard to estimate the financial side.
- ► We have rebased our asset recovery estimates off the lower base. Revenues will also be volatile in this business, but given Burford's ongoing growth, they are unlikely to be significant relative to the total in our forecast period.

The net effect is to give significant upgrades to our estimates. Our underlying 2018E EPS goes from $0.58 to $0.81, an increase of 40%, and 2019E EPS increases by 78% to $1.41. We also introduce a 2020E EPS of $2.01.

We note that our 2018E EPS remains below the 2017 figures. The RoIC for 2017 was significantly above the long-term average, at 62% for the year. Our increased assumption of 37%, as stated above, corresponds to the cumulative average RoIC. Invested capital has grown significantly, but the net result is an EPS estimate lower than 2017.

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

- An increase in the RoIC on investments to 90% for all future years, i.e. 45% per annum.
- A decrease in the RoIC on investments to 60% for all future years, i.e. 40% per annum.
- A doubling of rate the growth in additions to invested capital in 2018 only from 25% to 50%, i.e. from $615m to $681m.

Sensitivity analysis

$m	2017	2018E	2019E	2020E
EPS	1.27	0.81	1.41	2.01
RoIC at 90%				
u/l EPS		1.06	1.80	2.52
Change		30%	28%	26%
RoIC at 60%				
u/l EPS		0.60	1.07	1.55
Change		-26%	-24%	-23%
2018 IC growth doubled				
u/l EPS		0.81	1.53	2.24
Change		0%	9%	12%

Source: Burford Capital, Hardman & Co Research

There has been some concern in the market about Burford's rating. Although our 2018E EPS remains below the 2017 results, looking through to 2019E, the estimated P/E is now 13.6x. This does appear to be lower than multiples for other companies offering a similar growth profile.

Summary financials

Year-end Dec ($m)	2015	2016	2017	2018E	2019E	2020E
Revenue	103.0	163.4	341.2	268.8	410.9	558.7
Expenses	25.8	39.0	52.3	64.1	75.9	89.9
Operating profit	**77.2**	**124.4**	**285.1**	**204.7**	**335.0**	**468.9**
Finance cost	9.3	14.1	24.3	38.7	46.2	56.6
Exceptional items	0.0	-5.9	-3.8	0.0	0.0	0.0
Reported pre-tax	**67.9**	**104.1**	**249.2**	**154.4**	**277.1**	**400.6**
Reported taxation	-2.2	4.8	0.1	3.0	4.3	5.8
Minorities	1.2	0.6	0.0	0.0	0.0	0.0
Underlying net income	**64.5**	**114.2**	**264.8**	**169.0**	**293.2**	**418.1**
Statutory net income	64.5	108.3	249.3	157.3	281.4	406.4
Underlying basic EPS ($)	**0.32**	**0.55**	**1.27**	**0.81**	**1.41**	**2.01**
Statutory basic EPS ($)	0.32	0.53	1.20	0.76	1.35	1.95
DPS ($)	0.08	0.09	0.11	0.13	0.15	0.17
Balance sheet						
Total equity	433.1	462.2	664.5	798.0	1,052.0	1,458.4
Invested capital	252.9	394.3	631.4	1,005.8	1,393.6	1,783.9
Fair value balance	334.2	559.7	982.2	1,487.1	2,090.9	2,777.2
Total assets	**608.7**	**968.2**	**1,318.0**	**1,767.8**	**2,171.8**	**2,578.2**
NAV per share ($)	2.12	2.22	3.19	3.83	5.05	7.00
Underlying ROE	**16.0%**	**22.1%**	**35.9%**	**18.5%**	**26.9%**	**29.6%**

Source: Hardman & Co, £1=$1.40

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