RESEARCH REPORT
23 March 2022

UNDERVALUED SHARES

BURFORD CAPITAL: PROFITING FROM DISORDER

LME is facing threat of lawsuits over $4bn of cancelled trades

METALS
Simon English

THE London Metal Exchange is facing possible lawsuits from hedge funds over chaos in the nickel market that saw $4 billion of trades suddenly cancelled.

Hedge funds and other market participants are taking advice and have been told there are legal grounds for a potential claim that would run into many millions of pounds. Funds including AQR Capital Management are discussing a possible suit.

Two weeks ago the LME suspended nickel trading after the price doubled. It then cancelled trades placed that day prior to the market closure, which helped Tsingshan Holding, a Chinese steel producer that was "short" the market. The LME is owned by China's Hong Kong Stock Exchange, the HKEX.

The LME insists the decision to close the market and reverse trades was its own.

One participant close to the legal process said: "The market is waiting to hear from the LME a clear, coherent and rational explanation of why trades were retrospectively cancelled."

Mark Thompson, a former metals trader at Trafigura Group, earlier told Bloomberg: "Suddenly the LME just looks incompetent. They need root-and-branch reform."

The LME declined to comment on the prospect of legal action.

It did say: "The situation we saw in the nickel market is unprecedented; however, we fully recognise that we must consider taking action in order to prevent such a situation from happening again."

@SimonEngStand

LSE/NYSE-listed Burford Capital is the world's #1 financier of lawsuits. The company funds lawsuits that promise a financial payoff.

The current geopolitical developments, complex sanctions, and resulting deglobalisation are likely to create manifold new lawsuit opportunities for the company involving juicy assets and large claims.

With a GBP 1.6bn / USD 2.1bn market cap, Burford Capital is the best placed company to monetise this trend at scale. The stock is currently trading below even its liquidation value, and 2022 will likely bring both a short-term hype and a more lasting revaluation.

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UNDERVALUED SHARES

A non-obvious crisis beneficiary

Dear Member,

The current global situation has already produced several new trends that are obvious, such as rising food and energy prices, growing investments into defence, and a stronger focus on cyber security.

However, trends that have already become obvious to the wider public come with a distinct disadvantage when it comes to investing in them. They are usually already priced in, at least to some extent.

Which begs the question, which non-obvious trends are yet to emerge?

One of the not-so-obvious effects of the current global crisis will probably be a boost to so-called litigation finance. This is a specialty sector of finance where someone provides financial backing to a plaintiff for waging a lawsuit. If successful, the investor gets a percentage of the rewards from the lawsuit.

Recent developments will make for fertile ground for the legal industry:

- Sanctions will put corporations into situations where they will have to start legal proceedings to defend (or reclaim!) their assets.
- The polarised political environment will lead to high-profile divorce cases among the rich.
- Sovereign nations will have to battle out financial claims, be that over sovereign debt or other ownership issues.

Details aside, large-scale conflict and political disorder generally lead to more litigation. In a world that is becoming ever-more polarised and instable, an increase in legal battles seems a natural consequence. Not that we didn't have a lack of legal issues before – the legal industry reliably grows by 3-4% every year.

How to capitalise on this trend?

Litigation finance is the answer. With today's report, you can get exposure to the sector at a bargain-basement price and without having to invest into anything unusual or illiquid. There is a London and New York listed company that lets you bet on these trends.

How does it work?

When someone is looking to start a lawsuit but does not want to (or cannot) come up with the upfront costs for lawyers and other necessary work, Burford Capital is the company to call. It has the world's largest book of business among funders of legal battles, and it is also the most experienced. If you have a very large or very complex legal case, Burford Capital wants to hear from you. The bigger and the more complex, the better!

The company's history makes for interesting reading. E.g., Burford Capital once made USD 100m by backing the wife of a Russian oligarch in her divorce proceedings. The husband had tried to hide assets and once famously said (in imperfect English): "*I will burn this moneys rather then will give her.*"

As luck would have it, Burford Capital didn't just have the legal expertise and the capital to wage a lawsuit, it also had its own asset recovery team. The company was thus able to find out in which remote part of the world the oligarch had hidden his yacht.

Laughing all the way to the bank (source: *Independent, 16 July 2021*)

Business

Legal financiers paid £75m for role in Russian billionaire divorce battle

Burford Capital funded Tatiana Akhmedova through the High Court where she heard she was entitled to around £450 million from her ex-husband.

Simon Neville • Friday 16 July 2021 08:23

Tatiana Akhmedova *(PA Archive)*

The financiers who backed the ex-wife of a Russian billionaire in her High Court divorce battle have received 103 million dollars (£74.6 million) for their role in the high profile case.

Burford Capital resolved the issue through a legal case followed by a settlement, with all upfront costs paid by the company given that the ex-wife was bereft of funds. It's a long-standing rule at the company that legal cases won through the courts make an average of 2.5 times the investment in less than three years. Some cases make a multiple of that (though others are lost), and in this particular case, Burford Capital made 3.3 times its investment.

Since it was set up in 2009, investors backing lawsuits through Burford Capital have earned an average return of 20% p.a., or nine times their money over the course of 13 years.

Why is this opportunity available?

Burford Capital did not always handle its own corporate governance affairs quite as successfully as its court cases. In 2018, criticism from a short seller made the stock drop 80% in value. The short seller had spotted genuine weaknesses in the company's corporate governance (besides other accusations), and shareholders had to pay a heavy price. Even though this incidence took place in 2018, it has weighed on the stock price until now.

However, that was then. What's the current situation, and what is the outlook for 2022 and beyond?

On 29 March 2022, Burford Capital will publish its figures for 2021 and an outlook on the current year. Also, in June 2022, after a seven-year (!) wait, the company's largest and most important ever legal case is coming to a close. A USD 18m investment made in 2015 could lead to a multi-billion dollar payoff.

In my view, following a few years of being largely off the radar, the stock should have a new lease on life soon.

This is the first report in a series aimed at shedding light on non-obvious winners of the current environment.

Enjoy!

Best regards

Swen Lorenz
Undervalued-Shares.com

Executive summary

Burford Capital (ISIN GG00BMGYLN96) is an alternative asset management company that invests in litigation. The company provides capital to pursue legal claims and in return receives a portion of any eventual damages or settlements. It earns money from its own investments (USD 2bn of equity-funded legal assets) and from performance fees earned by managing investment funds (USD 2.6bn of client assets). Since 2009, the company has earned an average return of 20% p.a. on its equity.

With an estimated global market share of 30-40%, Burford Capital is by far the largest operator in litigation finance and seems destined to capture a significant part of the industry's future growth. All litigation finance providers taken together have provided less than USD 15bn in funding. The global legal industry generates revenue of >USD 700bn per year, and pending arbitration cases in the US alone amount to USD 2,000bn.

In August 2019, Burford Capital stock lost 60% of its value in just 48 following an attack by short seller Muddy Waters. The company has since addressed its corporate governance issues, its bonds are now trading at a premium, and its business appears to be stronger than ever. In the meantime, the company dual-listed on the New York Stock Exchange (besides the London Stock Exchange).

Burford Capital stock is currently trading at a valuation that is less than the liquidation value of its existing portfolio of cases. The company's significant intangible assets and growth potential, especially through launching funds with performance fees, are valued at zero. **Crucially, the market also currently values at zero (!) the optionality provided by the "Petersen case".** This relates to the 2012 expropriation of the majority shareholders of Argentinean oil company **YPF** (ISIN US9842451000). Burford Capital purchased these claims for USD 18m in 2015, and already syndicated 38.75% of its stake for a cash price of USD 236m to several investors. The remaining 61.25% could be worth between USD 0 (worst case) and USD 6bn (best case). **After a ten-year wait, the case will finally go to court around June 2022, and its adjucation or settlement can create a very significant one-off gain for Burford Capital – ranging from GBP 1-16 per share, i.e. up to twice the current market cap (see table on page 26).**

Ahead of the court date for the Petersen case, the stock should see a short-term hype. Burford Capital also has several potential catalysts coming up during the remainder of 2022 to gradually regain the market's confidence:

- The end of the pandemic restrictions will unclog the court system and lead to overdue cases getting resolved.

- The market will realise that many of Burford Capital's funding contracts actually make for a higher share of the payoff in case of delays (making it a beneficiary of pandemic-related delays).

- Burford Capital's largest ever fund, a USD 1bn vehicle co-funded by a Sovereign Wealth Fund, will likely announce that it has fully deployed its capital.

- Several of its best vintage funds are reaching maturity, and their "European waterfall" performance fee structure backloads performance fees.

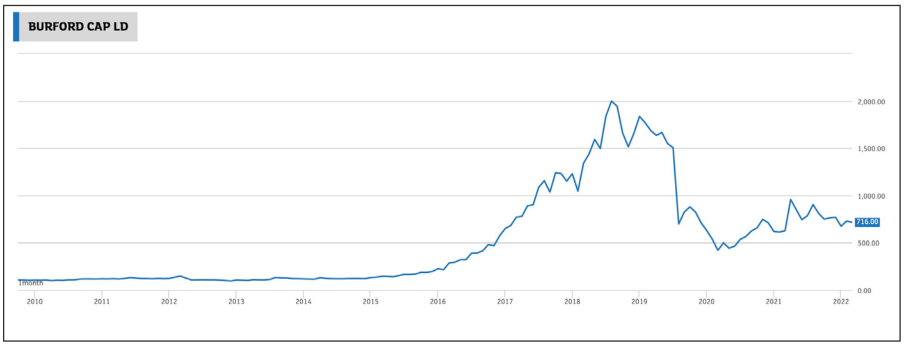
The company should also continue to gain traction among US investors. Trading on the NYSE already makes up 25% of the stock's liquidity, and litigation finance is a more widely accepted industry in the US.

All staff members of Burford Capital own equity in the firm, with many also invested in the company's investment funds. The two founders collectively own nearly 9% of the firm as well as significant fund investments. In 2021 alone, they purchased an additional USD 1.1m worth of shares at prices around the current level.

With a valuation below the liquidation value even when excluding the Petersen case, the Petersen case coming to a head within months, and several catalysts on the horizon, Burford Capital stock is probably good to surpass 1,000 pence this year. It could also become known as a beneficiary of current world events, which seem destined to lead to many new lawsuits involving multi-billion dollar assets. Four years after the Muddy Waters attack, this is now a stock to take a fresh look at. Burford Capital is due to report its 2021 annual figures and outlook on 29 March 2022, which should be a first step towards bringing the company back in focus.

Burford Capital at a glance	
Share price:	715 pence (GBP), USD 9.60
ISIN:	GG00BMGYLN96
Listing*:	London Stock Exchange, New York Stock Exchange
Outstanding shares:	219,049,877
Market cap:	GBP 1.6bn / USD 2.1bn
Major shareholders:	Mithaq Capital (10.5%), Invesco (6.4%), Ameriprise Financial (5.0%), CI Investments (5.0%), Conifer Management (5.0%), Prof. Jonathan Molot (Founder, 4.6%), Christopher Bogart (Founder, 4.2%)
Website:	www.burfordcapital.com

* 25% of the share trading is on the NYSE and 75% on the LSE



Burford Capital stock since its IPO in 2009

Chapter 1: How does litigation finance work?

What you are going to learn in this chapter:

- **How a plethora of terms has left the public confused about the industry.**
- **Why litigation funding is an asset, not a loan.**
- **The reasons why so many corporations have started to use litigation finance.**

Bringing finance and law together

Litigation finance is not an easy industry to get your head around. Its complexity starts with the fact that there are multiple terms used to describe the industry, including (but not limited to):

- Litigation finance
- Settlement funding
- Legal funding
- Lawsuit loans
- Professional funding

The most widely known variation of litigation finance are legal defence funds. When a high-profile figure is the subject of a legal case or prosecution, they sometimes set up a legal defence fund that anyone can pay into to support their case. However, legal defence funds are usually used on the side of defendants. Litigation finance, on the other hand, is usually used on the side of a plaintiff – it's offence rather than defence!

Pursuing a legal case is expensive and risky. Most law firms still operate based on hourly fees, and bills quickly run up to astounding amounts. A very large percentage of legal cases that could be brought to trial never goes to trial because the plaintiff simply wouldn't have the money to pay for the legal team. As such, litigation finance is doing something for the general good, too: it helps the little guy succeed against the bad guy.

Case in point, the now-famous case of Russian billionaire Farkhad Akhmedov and his former wife, Tatiana Akhmedova.

Akhmedov didn't want to pay his wife any money when getting divorced, even after an English court had ordered him to do so. As a billionaire, Akhmedov had all the means in the world to play dirty tricks, including hiding his assets behind elaborate schemes. Tatiana Akhmedova did not have the financial means or the know-how to prosecute her husband.

Burford Capital to the rescue. The company funded the subsequent legal work and even the asset recovery, helping Tatiana Akhmedova to settle her case. Burford Capital, in turn, made 3.3 times its investment in the case.

Had the case not yielded any result, Burford Capital would have lost its entire investment. As such, litigation finance is different from giving a loan. Litigation finance never needs to be paid back and the risk is solely for the financier to carry. As such, it has similarities to venture capital. Litigation finance is high risk, high return.

It's also about owning an actual asset, which makes it a unique niche within the specialty finance business. The following section will make that clearer.

Creating a valuable asset by taking a burden off corporations

It can't be emphasised enough that litigation finance is not a loan but a form of asset purchase. The plaintiff sells a right to a percentage of the future payoff from a lawsuit to the financier. This right then appears as an asset on the balance sheet of the financier.

There are a number of accounting and managerial factors that have made litigation finance a thing among large corporations, if only during the last decade.

Until the late 2000s, litigation finance was a business mostly conducted in conjunction with law firms. Lawyers would have rung a firm like Burford Capital when they had a client that needed funding and promised an interesting payoff. Since lawyers have an interest in cases to go ahead, they are incentivised to point clients to firms like Burford Capital. The case of Akhmedov would have been a classic case of litigation finance referred over by a law firm.

Since the early 2010s, another pillar of litigation finance has arisen.

For corporations, legal issues had long been a painful problem that they mostly simply wanted to get rid of:

- Legal expenses weigh on profitability in the short term, and they also inflate the general expenses of a business. Most CEOs, CFOs and board members would rather not pursue legal cases because of what they do to a firm's financial metrics and also because their outcome is unpredictable.

- Pursuing legal claims is not something that is generally considered a part of the normal day-to-day business, and as such no one is really focussed on the subject.

- Even if a case is won, the payoff will be treated as a one-off by shareholders. Stock market investors don't generally include the win from a legal case in their valuation of a business. They exclude it from their calculation when applying a multiple to a company's earnings.

However, companies have now understood that working with a litigation financier offers them free upside with zero downside. It was Burford Capital and a few other large players in this field that educated corporations about the benefits of litigation finance.

If a company has a worthwhile legal case, an agreement with the likes of Burford Capital can:

- Take all legal expenses off the company's profit and loss statement.

- Increase the chance of success because of the expertise of the litigation financier.

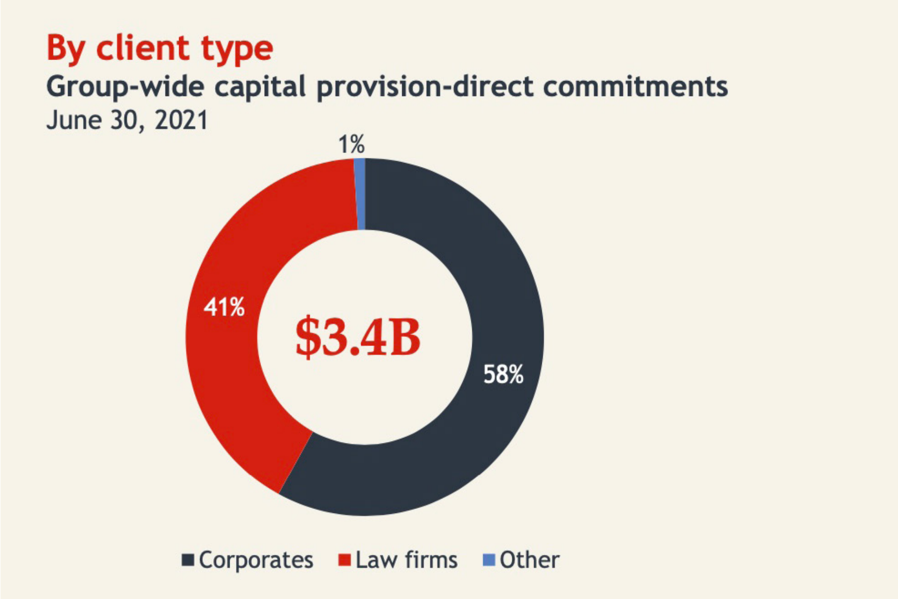
- Lead to a nice one-off payoff to the company with no upfront investment, if the case is successful. If it's not, no harm was done at all on the level of the corporation.

Litigation funding allows corporations to move legal costs off their financial statements, invest their cash elsewhere instead, and still benefit from the upside of the legal case. With operators like Burford Capital making funding available at scale, pursuing legal claims has become a bit of a no-brainer for corporations. Provided, of course, their case has merit. Judging the merits of a case is part of the expertise that Burford Capital and similar players bring to the table.

Voluntary settlement vs. judicial decision

Over the 13 years of its existence, Burford Capital has developed significant expertise in judging which cases are worth pursuing and which aren't.

Source: Burford Capital investor presentation, November 2021



It shows in the return that the company has achieved for its investors: an average return on equity of 20% p.a. since 2009. For investors in its funds, returns will have varied (because funds have different risk profiles) but largely been similarly good (relative to the risk taken by the funds). In 2018, these returns even attracted a Sovereign Wealth Fund that invested an initial USD 600m in Burford Capital's legal cases through one of the company's investment fund structures.

There is a distinct effect once a defendant realises that their opponent has secured legal funding AND secured it from a highly experienced litigation financier: their willingness to settle usually increases dramatically. Of the cases Burford Capital takes on, 60% end with a settlement, 30% are won in court, and just 10% are lost in court. As such, the company can claim a 90% success rate in the cases it takes on (the success rate is slightly lower if you factor in the company's expenses, i.e. which cases it made a positive financial return on – between 75-85%).

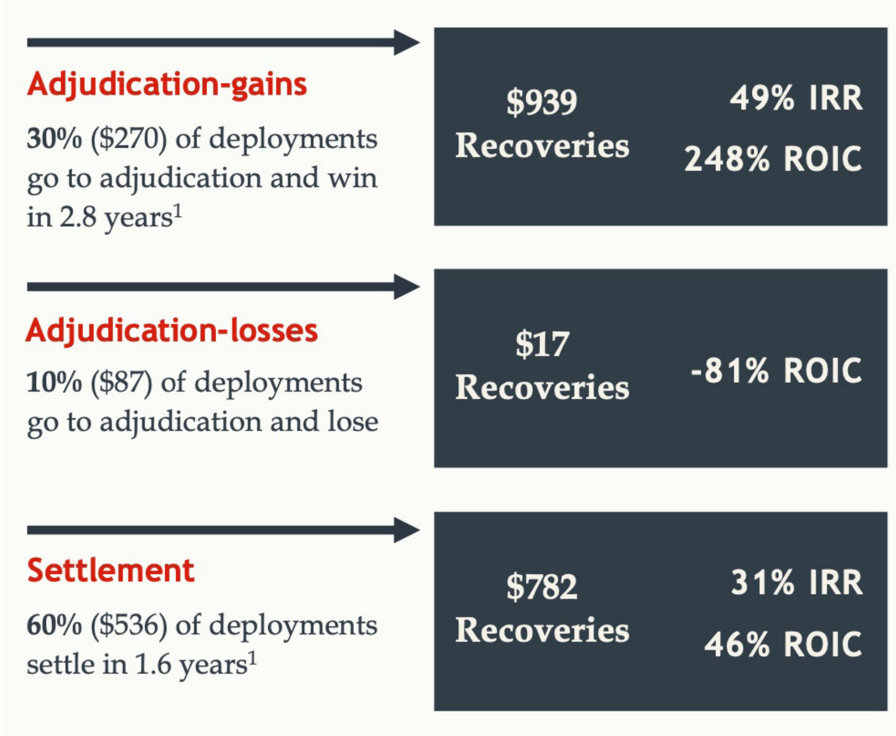
Once funding is in place to pursue a case, one of two things will happen:

- A defendant will agree to settle, which makes it quicker than to drag the claim through the court system. Typically, a settlement means Burford Capital gets a return of 46% on its invested capital after 1.6 years.

- If the case goes to court and Burford Capital fights it all the way to the end, it usually takes just under three years to resolve but produces an average return of 248% on invested capital.

The multiples achieved through this type of financing shows the fundamental asymmetry in this type of investment. It is very complex and very risky, but it yields very high returns if it succeeds. Even after factoring in that 10% of cases (and consequently the entire investment)

Source: Burford Capital investor presentation, November 2021



are lost, it's a superbly profitable area of investing. What's more, the returns that Burford Capital achieves from financing legal cases are entirely independent from the situation on stock markets. This is an uncorrelated asset class if ever there was one.

On the back of this model, Burford Capital has built a multi-billion business. Chapter 2 will explain in more detail where the company has gotten to so far.

Chapter 2: The House of Claims

What you are going to learn in this chapter:

- **Why Burford Capital had a slow start after the Great Financial Crisis.**
- **The eight areas that the company has built up real strengths in.**
- **What a realistic interpretation of the events of 2018 looks like.**

How it all started

Unsurprisingly, Burford Capital was set up by two learned men from the field of jurisprudence, Prof. Jonathan Molot and Christopher Bogart. Initially, the firm was focussed on commercial litigation and international arbitration matters brought in the US. The pitch to investors was to offer uncorrelated returns from a new asset class at a time when markets were still reeling from the fallout of the Great Financial Crisis.

When Burford Capital got off the ground in 2009, Prof. Molot had a reputation as the most published scholar in the legal claims and legal finance field. He had been an advisor to hedge funds that explored litigation finance while his co-founder Bogart had previously managed the legal team of Time Warner, one of the world's largest corporate legal teams with 350 in-house lawyers. Bogart had also gathered management experience in a variety of other positions, including as Chief Executive Officer of Time Warner Cable Ventures.

Prof. Molot and Bogart launched Burford Capital as a closed-ended investment company through an IPO on London's Alternative Investment Market, raising an initial GBP 80m priced at 100 pence per share. Their ambition had been to raise GBP 200m – showing, in hindsight, how even today's really successful businesses often didn't find it easy to get a start. Today, the company manages a portfolio approaching USD 5bn.

When Burford Capital was set up, the world of litigation finance was still in its infancy and winning business primarily depended on personal relationships with lawyers. Cases were mostly a lot smaller, also due to a lack of available funding. Few investors were interested in backing litigation finance, mostly because they didn't understand the concept or thought it was dubious.

Since then, the industry has changed significantly, and Burford Capital has been at the centre of it almost the entire time. The company today is the world's largest provider of litigation finance and controls 30-40% of the global market of litigation funding (although no one has any official figures). It's also one of the constant innovators in the industry, to the point of enlarging the entire market for everyone's benefit.

The company has racked up quite a few achievements, as the following points make clear.

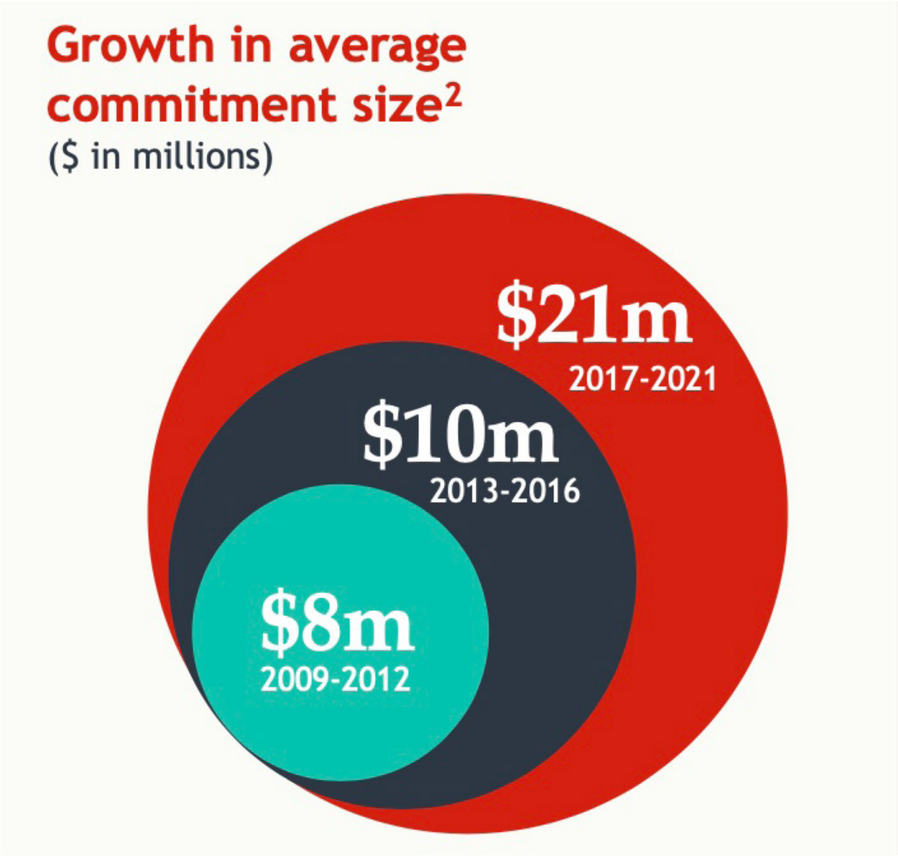
1. Increase in average case size

Initially, the average case funded by Burford Capital was USD 8m.

Today, the average claim is USD 21m.

There are few litigation financiers that can keep up with the size of cheque that Burford Capital can write to plaintiffs to fund complex legal cases that involve large amounts. The largest investment in a single case made by Burford Capital was USD 200m. Even a litigation funder with USD 1bn in capital – and there are probably no more than ten of them around the world – would struggle to fund such a large

Source: Burford Capital investor presentation, November 2021



capital outlay. The heft of its capital base allows Burford Capital to operate in a part of the market where it faces less competition.

The company also benefits from economies of scale. The amount of legal work required for a lawsuit does not increase proportionally with the size of the claim, which makes large cases more lucrative to pursue.

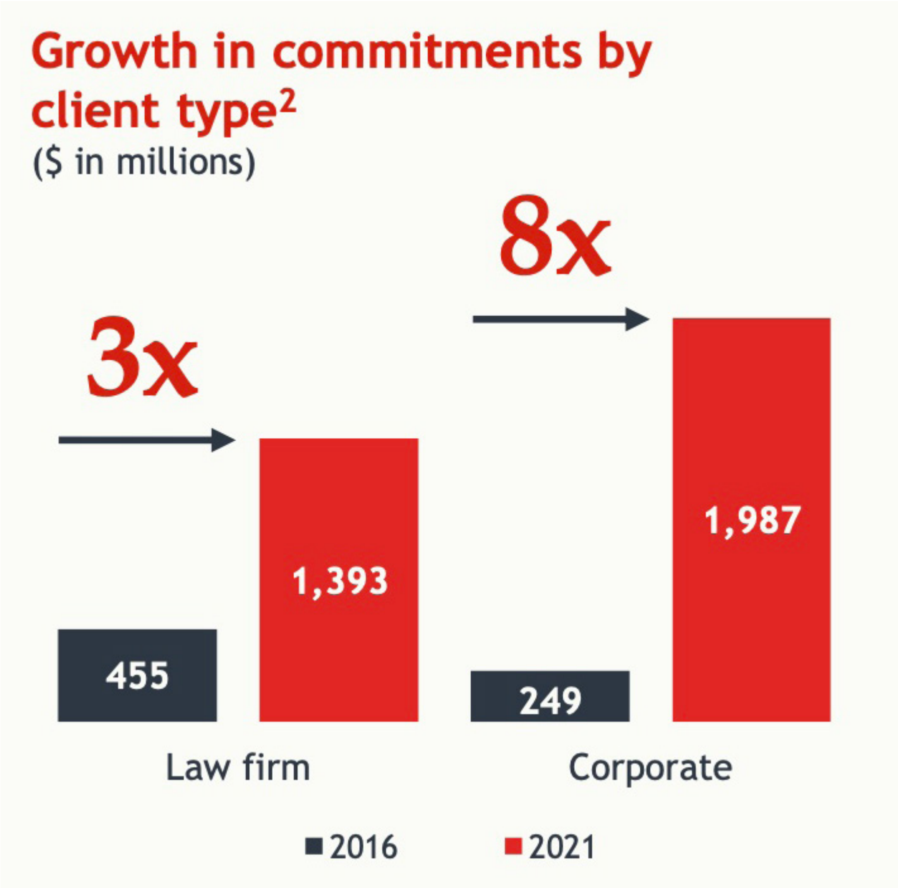
Case in point, as it took on larger cases over the past years, the company's average return went up measurably. Whereas most asset managers experience decreasing average returns as they grow in size, Burford Capital is still in a phase where the underlying mechanics of the industry allow it to increase its returns.

2. Additional corporation business

As described in chapter 1, while corporations used to shy away from pursuing legal claims, they are now much more likely to seek a collaboration with a litigation financier.

Part of this is also due to the work that Burford Capital has done over the past decade. As a publicly listed company with over USD 1bn in shareholder equity, Burford Capital was able to make a much more credible case to the CEOs, CFOs and boards of large corporations. Critically, as a UK/US company, it finds it easier to gain the trust of cor-

Source: Burford Capital investor presentation, November 2021



porations in the US, which remains the world's largest market for legal battles. Through its sheer size, its listing on the stock market, and its corporate culture, Burford Capital has single-handedly increased the overall size of the market by attracting corporations that previously would not have considered litigation finance.

Since 2016 alone, Burford Capital's business with other corporations has grown eight-fold, from USD 250m in commitments to USD 2bn today.

3. New investors through track record in returns

I remember when, in the late 2000s, a fledgling litigation financier in London pitched their investments to me. It sounded good, but they had no track record and I passed on the opportunity for that reason.

Building a track record is the single-most difficult (and valuable) aspect of building a fund management business. There is no way to cut corners. To get a ten-year track record, you simply need to have been in business for ten years and successful in your decisions during that period.

13 years into building Burford Capital, the company now has a stellar track record.

Since its inception, the company has achieved annualised returns of 20% p.a. when measured against its shareholder equity. Since 2009, Burford Capital shareholders have earned 900%. The company also has investment funds that allow external investors to co-invest, and while their returns will have varied, according to the funds' risk profiles, they will have been similarly good. These funds were set up for different categories of claims and yield a performance fee between 10-20%.

Thanks to its track record, Burford Capital now has the ability to mobilise other investors to put money into litigation, and it can do so on rather advantageous terms. In December 2018, the company signed up an unnamed Sovereign Wealth Fund to co-invest in its USD 1bn Burford Opportunity Fund C. The agreement involved Burford Capital contributing 33% of the fund from its own equity but receiving 60% of the fund's profits, whereas the Sovereign Wealth Fund contributed 60% of the capital but receives just 33% of the profits. In effect, the Sovereign Wealth Fund is paying a performance fee equivalent of 40%! That's the sort of arrangement a fund manager can achieve once it has a successful track record (and can bring co-investment to the table to have skin in the game).

At last count, Burford Capital had USD 2.6bn of external money invested in its funds. Going forward, the company can probably decrease the use of its own equity and increasingly make use of "Other Peoples' Money" (OPM). Longer term, this could make Burford Capital even more profitable since it could move to a more capital-light model.

It might also allow for some of the company's equity to be returned to shareholders as a special dividend, especially if the Petersen case (see chapter 3) leads to a huge one-off cash influx.

Even if someone now magically raised a few billion dollars to set up a competing operation, it will take them at least three years to deploy the funds and a further five to eight years before they have a track record. Burford Capital is in an extremely strong position in terms of leading the pack.

Source: *yahoo!finance*, 19 December 2018

LAW.COM

Sovereign Wealth Fund Bets on Litigation Finance in $667M Burford Deal

December 19, 2018

Christopher Bogart, Burford Capital CEO. Courtesy photo.

Burford Capital LLC is getting some serious money from a serious source.

4. Track record in court

Burford Capital's success ultimately hinges on its ability to accurately predict which lawsuits are worth financing and which aren't. As a sub-aspect of this, the company's track record in court significantly helps with getting defendants to agree to a settlement. While a settlement yields a lower payoff, it has a faster turnaround time.

Burford Capital has built a track record of achieving either a settlement or an outright win in 90% of its cases. It is worth a lot to go into a court case and say: "*Listen, with our loss rate of 10%, the odds are heavily stacked against, why not speak to us about a settlement and make this all a lot easier on yourself?*"

If you are a defendant and your opponent manages to sign up Burford Capital as their litigation funder, you are usually well advised to negotiate a settlement. It'll probably only get more expensive if you don't.

This, too, counts among the company's valuable intangible assets.

5. Repeat client base

Most private clients only ever need the services of Burford Capital once – unless you become a serial divorcee! However, corporate clients and law firms that refer business to Burford Capital can become valuable repeat clients.

Since 2009, 72% of its clients have returned to speak to Burford Capital about another opportunity. Its network of existing clients has become the company's most valuable acquisition tool for future business.

6. Brand recognition

If you mention litigation finance, most people in the industry immediately think of Burford Capital. According to a survey published by the company, 86% of interviewed lawyers that are able to identify a legal finance provider named Burford first or solely.

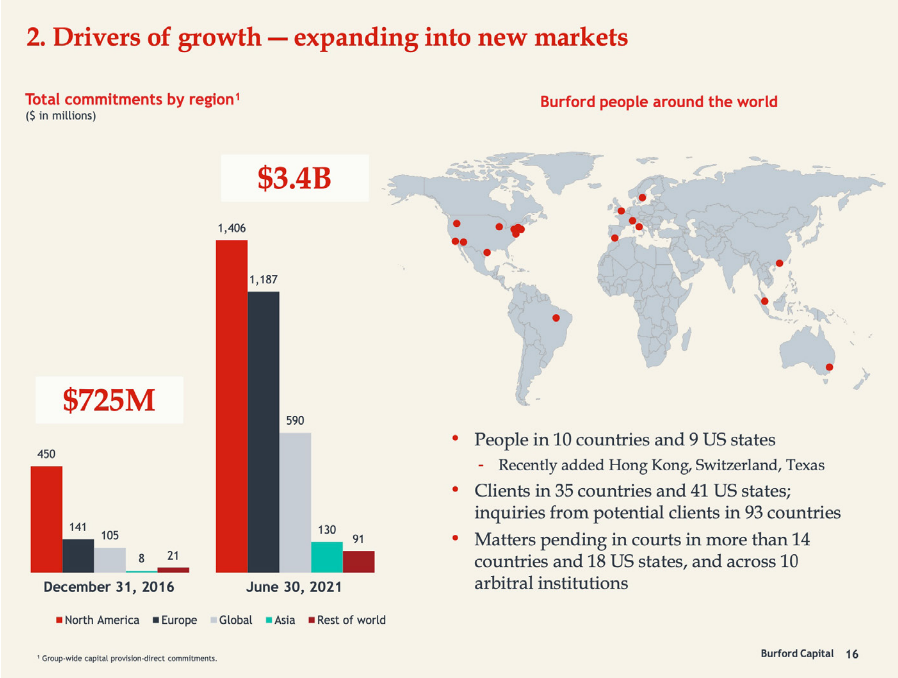
As a company-funded survey, these findings need to be taken with a grain of salt. However, as the largest litigation finance specialist in the world and one of only three publicly listed operators, it's fair to say that the company benefits from an unusual degree of visibility in the industry. Burford Capital reported that it has had referrals from 92 of the world's 100 largest law firms.

7. Geographical reach

What started as a UK/US business is now established with offices in ten countries and clients from 35 countries. In the US, Burford Capital has offices in nine states, and its US clients hail from 41 states.

On the one hand, the company has already spread its wings to many high-value jurisdictions where litigation finance is legal, such as Switzerland and Hong Kong. It has also already gobbled up some smaller players, e.g. through its 2016 acquisition of Gerchen Keller Capital (GKC), a Chicago-based company and the then largest litigation fund manager in the US with USD 1.7bn in assets under management.

Source: Burford Capital investor presentation, November 2021



On the other hand, Burford Capital's current footprint still leaves much of the world map blank. Also, the total addressable market remains underpenetrated, as described in more detail in chapter 3.

8. Claims families

Everyone has heard of class action lawsuits, i.e. the kind of lawsuits where a large number of plaintiffs groups together to pursue their case together. One such class action lawsuit is that of 125,000 alleged glyphosate victims that have sued **Bayer** (ISIN DE000BAY0017), a company that I have published a separate report about.

When Burford Capital comes across a legal situation where there is more than one claim, it pursues a similar strategy: related legal claims from different clients are grouped together in so-called claims families. Such claims families involve the use of replicable legal strategies and as such, they have in-built economies of scale.

In 2020, Burford Capital concluded a claims family that involved 18 cases in the North American insurance industry. The claims family yielded groupwide realisations of USD 425m and a return of 57% p.a. on the invested capital.

Not a bad business, if you can get it. Which begs the question, if it's SUCH a great business, why isn't Burford Capital stock already trading much higher than is currently the case?

2019 – Burford Capital's annus horribilis

In 2018 and early 2019, Burford Capital was a company that everyone wanted to own a piece of. The stock had risen from 100 pence in 2009 to 2,000 pence in August 2018. Worth GBP 5.5bn, the company was one of the highest-profile success stories listed on the London Stock Exchange. Everyone expected "the Goldman Sachs of litigation finance" to keep growing. These were the golden days of the Burford hype.

However, in August 2019, Burford Capital lost 60% of its value in the space of just 48h. Short sellers attacked, and they caught the company off guard.

Muddy Waters, an infamous short seller with a successful track record of pointing out frauds, accused Burford Capital of bad governance, dodgy accounting, and collusion with large investors to artificially inflate its business and stock price. Worse still, it said that the company was "*arguably insolvent*". Investors panicked and ran for the exit.

This is the episode that EVERYONE brings up when speaking about Burford Capital, even today. The short attack had a lasting effect on the stock because it made investors wonder if there might be something to it.

Source: *Reuters, 7 August 2019*

U.S. MARKETS AUGUST 7, 2019 / 3:53 PM / UPDATED 3 YEARS AGO

Muddy Waters wipes 2 billion pound off Burford Capital shares in latest short attack

By Reuters Staff 2 MIN READ

LONDON (Reuters) - Short-seller Muddy Waters has sparked a 2 billion pound ($2.4 billion) slump in shares of Burford Capital BURF.L, a London-listed fund that finances lawsuits in return for a cut of any payouts, after criticizing its accounts and saying it had bet on its shares falling.

Burford Capital refuted every single claim that Muddy Waters had published about its accounting practices. However, even if Muddy Waters had been wrong on every single count, the outside perception of the entire affair did make some aspects of Burford Capital look rather unfavourable. (I didn't hold stock at the time and would like to believe that I have been a neutral observer up to now.)

The company indeed had weaknesses in its corporate governance, most famously the fact that the founder's wife was also the company's CFO. This obvious conflict of interest had been known about for years and it had been widely disclosed. However, once you had one of the world's most successful short sellers criticise the company's accounting, it suddenly became much more of a live issue.

Who was right or wrong, and how does this affect any potential investment today?

Muddy Waters vs. Burford Capital – 3 years on

Muddy Waters criticised Burford Capital's so-called mark-to-model accounting.

Burford Capital's balance sheet mostly consists of legal claims. Each year, the company has to decide what value to assign to the individual legal claims.

What is the "right" value for a legal claim in a lawsuit that is likely going to take seven years and is currently in its third year? This is not an easy question to answer. Because of the nature of the business, there is a significant degree of subjectivity to valuing these claims. Public equity markets are littered with cases where CEOs, CFOs and boards overstated the value of such assets because it suited their needs, such as wanting to claim a bonus that year or inflate their share price.

As the name suggests, mark-to-model valuations are based on models. Models, in turn, are based on assumptions. There is no right or wrong answer *per se*, provided the underlying model is solid and the assumptions hold up to scrutiny.

When a company faces criticism from a high-profile investor with proven expertise in identifying fraudulent accounting, the market suddenly takes previously unnoticed issues a lot more serious. The founder's wife holding the post of the company's CFO is something that does not go down well in such a situation. Burford Capital had left itself vulnerable to criticism. This included not just the situation with the founder's wife, but also other structural deficits in its corporate governance, such as its refusal to disclose executive remuneration policies.

What should investors make of it all?

Today, we have the benefit of hindsight and can assess the claims made by Muddy Waters by looking at developments since then:

- Burford Capital changed its governance structure. E.g., the wife-CFO was replaced with a new CFO and executive remuneration policies are now getting disclosed.
- In January 2020, a class action lawsuit against the company, where the plaintiffs alleged Burford Capital had misled investors about operating performance, was dropped.
- In October 2020, the company dual-listed its shares on the New York Stock Exchange. To get a listing in New York, the directors had to accept criminal liability for any potentially fraudulent claims.
- The founders and other management members repeatedly increased their personal investment in the firm. In 2021 alone, the two founders purchased additional Burford Capital stock for USD 1.1m at prices around the current stock price.

Crucially, Muddy Water's insolvency punchline did not work out. Burford Capital is still trading, with no signs of insolvency. Its bonds temporarily traded at distressed levels, but they are now back to trading even at a premium. When it comes to moving on from the Muddy Waters affair, the bond market seems to be ahead of the stock market. Unsurprisingly, even Muddy Waters isn't always right in its assessment, as it conceded in August 2021 when giving up on its short of Tesla stock.

I judge such cases on the basis of the key peoples' personal interests.

Burford Capital's two founders collectively hold 8.8% of the share capital, and they are also personally invested in the company's funds. Would someone with a triple-digit personal fortune, a background in law, and an existing stock market listing risk it all just to get the stock listed on another stock exchange? Also, every employee of the company owns equity, too, and many are also invested in the company's investment funds.

Without a doubt, any management will be tempted to use mark-to-model accounting to make their company look as good as possible. There is probably not a single significant-sized company in the world that uses mark-to-model accounting where you couldn't argue controversially about the valuation of some of the assets. However, there are also safeguards built into the system, including ones that a company would find difficult to manipulate. E.g., much as the management of Burford Capital could artificially inflate the value of a lawsuit for a while, any excessive marking up would be exposed at the time the lawsuits come to an end. The average duration of a lawsuit at Burford Capital is 2.8 years, so the time between inflating the value and getting called out by the reality of the court judgments wouldn't be very long.

In a company where every employee holds stock and a very high percentage of employees have been trained in the legal profession, it's unlikely that large-scale fraud could go on for years without a whistle-blower stepping forward. Several high-calibre new board members joined Burford Capital since the Muddy Waters publications, and they, too, will have done their due diligence before accepting a directorship position with corresponding legal liabilities.

I'd say it's time to conclude that Muddy Waters was right with some of its criticism (famously, the wife/CFO issue), but wrong in other aspects ("arguably insolvent"). Without a doubt, its criticism of the mark-to-model accounting will have made Burford Capital all the more careful in this part of its business going forward. The company already revealed details of its revised valuation model to a crowd of American investors at its Capital Markets Day in November 2021 (the first such event since the events of 2018).

A lot of time has passed since these events, there have been significant developments relating to the business since then, and the company is now operating in a new environment. **It's likely that 2022 will become the year when Burford Capital moves on and get a new lease of life.**

How will that look like with regards to its stock?

Chapter 3 is going to take a close look.

Chapter 3: How undervalued is Burford Capital?

What you are going to learn in this chapter:

- **What the famous "Petersen case" is all about.**
- **Why Burford Capital is both complex and easy to value.**
- **The competitive risks of the company.**

The multi-billion claim against Argentina

Anyone who has ever looked at Burford Capital will instinctively ask: "*What's happening now with that Argentinean case?*"

The so-called "Petersen case" is the highest-profile litigation case ever pursued by Burford Capital.

It's also been the potentially most lucrative one. Burford Capital initially invested USD 18m into the case, and it already received USD 236m in cash from re-selling 38.75% of the claim to other investors. Its remaining 61.25% stake could yield Burford Capital over USD 5bn if it wins the case, or zero if it loses. There is even a scenario where it could yield a lot more than USD 5bn. For now, the company has the 61.25% stake in the claim on its balance sheet at a valuation of USD 775m, which is based on the price that external investors paid to buy their stake in the claim (i.e. "market price" rather than mark-to-model).

What is the Petersen case about?

In 2012, Argentina nationalised the publicly listed oil company **YPF** (ISIN US9842451000) by expropriating the majority holders of the share capital (but leaving the company listed on the stock market). Up to this point, the Spanish energy company **Repsol** (ISIN ES0173516115) and the financial holding company Petersen Energía had controlled the biggest part of YPF's share capital. The compensation paid by the Argentinean government was low and Repsol took the case to court. In 2014, the Argentinean government settled the case with Repsol by paying USD 5bn to the Spaniards in the form of a bond. Petersen Energía, on the other hand, was left holding the bag and went insolvent. That's when Burford Capital swooped in and purchased a claim to the payoff relating to Petersen Energía's stake in YPF's share capital. Burford Capital paid a paltry USD 18m for the claim. If there was ever a bargain of the century in litigation finance, this transaction will be on the shortlist!

In 2016, a court in New York agreed to hear the case, which was a major win for Burford Capital and the insolvency administrator of Petersen Energía (who continues to pursue the other half of the claim that Burford Capital didn't purchase). Following the win over the question of jurisdiction, Burford Capital decided to explore if there was demand on the secondary market for syndicating parts of the claim to other investors.

In December 2016, two investors paid USD 4m to buy a 1% stake in Burford Capital's claim as well as an option to participate in any further secondary sales. In effect, Burford Capital had already seen the value of its claim multiply in value. In early 2017, an additional 9% of Burford Capital's claim was sold at the same valuation. Further sales followed, and Burford Capital now holds 61.25% of the claim.

What's the claim worth if it all works out?

By now, an entire stand-alone report could be written about this single one claim held by Burford Capital. It's become the subject of lore both among legal scholars and shareholders of Burford Capital. The underlying details of this asset are very complex, and during my research I found that public reporting about it is rife with errors and omissions.

The easy scenario to work out is a loss. If the company loses the case, the claim will be worth zero. If that were to happen, Burford Capital would have to take a USD 775m hit to its earnings that year because of the value at which the company carries the claim on its balance sheet. That'd be a loss equivalent to around GBP 2.50 per share. This scenario wouldn't actually be as bad as it sounds, because Burford Capital has already cashed out USD 236m by selling parts of the claim for cash to other investors (i.e. it received a multiple of the USD 18m that it paid for the entire claim originally, leaving aside costs for legal work). Remarkably, even in the worst case, Burford Capital would still have made money from the investment – but show a one-off accounting loss that year because of how the claim is currently valued on its balance sheet.

The best-case scenario would be an outright win against Argentina. The 1992 statutes of YPF published at the time of the IPO in New York contained a provision that should Argentina ever decide to nationalise the company, it would have to pay the "fair value" for the expropriated shares. This was a straightforward regulation for the kind of transaction Argentina carried out, but Argentina didn't stick to it. In light of the clear-cut company statutes and given that Argentina already coughed up billions to pay off Repsol, it would seem that the country knows its considerably risk of losing the case. Of course, Argentina has its own financial issues, and a sovereign nation can drag its feet for many years when it comes to actually paying up – as, indeed, the Argentineans have done in other financial matters. However, the courts of New York usually apply a hefty 9% p.a. interest rate on overdue payments, so the time that has passed could actually work to Burford Capital's benefit. In a best-case scenario, the claim could be worth USD 5bn with 9% p.a. interest since 2012 added on top. That'd be about USD 10bn, thank you very much.

What's the most likely outcome?

In a little-noticed development, YPF in December 2021 admitted in its own publications that damages from the case could range from USD 3.5-5.2bn. However, it also stated that 95% of this figure could be corrected by applying exchange rate changes that have since taken place (i.e., having the Argentinean peso's devaluation works to the detriment of the plaintiff). How likely is it that a New York court would allow the Argentinean government to have exchange rate changes be applied solely to the detriment of a plaintiff? You be the judge.

There are a few investment bank analysts that have followed the case in detail and created financial models for the issue. Below is the 25 July 2021 calculation published by Jefferies, who have provided excellent research on the matter. As the bottom line shows, a loss of the case would create an (accounting, non-cash) loss of GBP 2.50 per share at Burford Capital, whereas a win could lead to a one-off gain between GBP 1-16 per share (not a typing error!). This wouldn't even require the US court to be particularly hard on Argentina with interest payments, but it would require Burford Capital to find a way to either enforce payment or sell on the claim to someone else.

Source: Jefferies, 25 July 2021

Exhibit 5 - Possible valuations of the YPF-related assets

Possible outcomes	Loss	Repsol equivalent	Closing price 29 Mar 2012	Closing price 23 Jan 2012	P/E 2y to 1 April 2012	P/E 2y to 12 Jan 2012	BUR reported mid-point	BUR reported upside
US$ share price	0.00	24.93	34.07	43.57	43.80	56.58	74.89	124.82
Petersen shares(m)	100.1	100.1	100.1	100.1	100.1	100.1	100.1	100.1
Value ($m)	0	2,496	3,412	4,363	4,386	5,666	7,500	12,500
70% entitlement								
58% after law firms' share								
35.525% after sales	**0**	**887**	**1212**	**1550**	**1558**	**2013**	**2664**	**4441**
Eton Park/Capital shares (m)	12.8	12.8	12.8	12.8	12.8	12.8	12.8	12.8
Value	0	320	437	559	561	725	960	1600
75% entitlement	**0**	**240**	**328**	**419**	**421**	**544**	**720**	**1,200**
Total BUR entitlement	**0**	**1,126**	**1,540**	**1,969**	**1,979**	**2,557**	**3,384**	**5,641**
Carrying value	773	773	773	773	773	773	773	773
P&L effect	**(773)**	**353**	**767**	**1,196**	**1,206**	**1,784**	**2,611**	**4,868**
% change	**(100%)**	**46%**	**99%**	**155%**	**156%**	**231%**	**338%**	**630%**
Value per share ($)	**0.00**	**5.14**	**7.03**	**8.99**	**9.04**	**11.67**	**15.45**	**25.75**
Additional value per share ($)	**(3.53)**	**1.61**	**3.50**	**5.46**	**5.51**	**8.14**	**11.92**	**22.22**
Value per share (£)	**0.00**	**3.78**	**5.17**	**6.61**	**6.64**	**8.58**	**11.36**	**18.93**
Additional value per share (£)	**(2.59)**	**1.19**	**2.57**	**4.01**	**4.05**	**5.99**	**8.76**	**16.33**

Source: Jefferies, company data

After years of fighting over jurisdiction and suffering pandemic-related delays during the so-called discovery process, the case is currently expected to go ahead in the second quarter of 2022 (probably June, though other sources have quoted April or May). The most time-consuming part of the case – the fact discovery process – has already been dealt with, and it seems quite likely that we are going to see a decision this year or 2023 at the latest.

An outright win by Burford Capital would not mean an immediate enforcement of the court's judgment. The defendant is a sovereign nation and has manifold possibilities to drag their feet over payment. Both sides can file an appeal, though if Burford Capital won and Argentina appealed, a US appeals court could require Argentina to post a bond in the meantime. Given what's at stake, this is not going to be a straightforward case, and fighting a sovereign nation is no small feat. On the other hand, the 2012 case of Elliott Management vs. Argentina famously demonstrated how a private investor can go after the international assets of a sovereign nation in order to enforce payment. In more recent times, UK-based Cairn Energy won the right to seize international property of the Government of India as part of a long-running dispute over USD 1.2bn.

Also, there comes a point when Argentina will probably want to settle the matter somehow as it becomes too much of a drag on the government and just ends up making lawyers rich. The country did settle

Sovereign nations are no longer immune to private creditors (source: *BBC, 8 July 2021*)

Cairn Energy gets right to seize Indian assets in tax row

8 July 2021

Cairn has identified assets that could be seized, including ones owned by Air India

UK oil firm Cairn Energy has gained the right to seize Indian state assets in France worth more than €20m (£17m) as part of a long-running tax row.

with Repsol after all (in itself probably an admission of guilt), and it has a history of settling other claims as well when it ran out of runway for dragging things out. As you will know from my research reports about **CRESUD** (ISIN US2264061068) and **Pampa Energía** (ISIN US6976602077), Argentina currently benefits from rising commodity prices. This influx of cash could make it easier for the country to cough up the cash to settle the case. Burford Capital could also decide to sell the claim to someone else following a win, and leave the pursuing of payment to a new owner. It could also pursue a continuation of the existing strategy of selling on some of the claim at a higher valuation to pull out some cash and keeping the remainder.

Much as the Peterson case could yield a very significant additional pay-off for shareholders of Burford Capital, it's not what drives the company forward. The Petersen case is more of a bonus – and it's currently thrown in for free, on top of an undervalued, successful business.

Valuing Burford Capital

Burford Capital is both a complex and a simple company to analyse.

It's complex in the sense that it has an unusual business model, and the finer details of its existing investment portfolio are impossible to understand unless you have access to internal data about the company's legal cases.

Such access is something that Burford Capital will always be reluctant to provide. Few things upset a judge in a court of law more than plaintiffs or defendants discussing details of a case in public before a conclusion is reached. As a public company, Burford Capital is in the difficult position of having to report to its shareholders but without damaging any of its existing lawsuits by saying too much about the details. It also has to respect the client privilege of lawyers. By its nature, this company will have to keep its cards close to its chest in many instances.

On the other hand, Burford Capital is also fairly simple to analyse because it really only consists of a small number of moving parts:

- Operating expenses for lawyers and general overhead. Human resources account for 75% of the company's operating expenses, which makes the annual expenses easy to estimate.

- Average returns achieved on the cases that the company is invested in with its equity.

- Performance fees from investment funds that the company manages on behalf of external investors.

- Debt, i.e. interest and eventual repayment.

Any valuation work is aided by the historical data and models that Burford Capital has developed over time. Because of its 13 years of operating in this industry and the large number of cases it has brought to a conclusion through settlement or in court, the company has a pretty good understanding of the percentage of cases that it is likely to win or lose, how many will be settled and how many will go through court, and what the likely realisations from lawsuits will be. This is the kind of proprietary knowledge that any such business would build up over time, and Burford Capital has built a proprietary database.

Using this historical data, the company was recently able to predict the financial outcomes of its portfolio of legal cases with an accuracy of 96%.

It's important to keep in mind that Burford Capital was originally set up as an investment fund, i.e. the primary aim was to invest its shareholders' equity into litigation. Managing external money was only added later.

Using this predictive model, it's possible to calculate what is probably the most conservative possible valuation of Burford Capital. **If the company was sent into liquidation tomorrow, how much cash would shareholders receive?**

In the case of a liquidation, the following would have to be taken into account:

- Operating costs until all remaining cases are concluded (taking into account an average time of 2.8 years for cases to get decided, with some cases requiring up to seven years to unwind).

- Repaying the company's outstanding debt (several bond issues).

- Receiving the payoffs from the cases that are won as well as performance fees from the investment funds managed by Burford Capital.

- Any payoff from the YPF case.

Leaving aside the YPF case, in a liquidation scenario, Burford Capital would yield about USD 2.2bn (around GBP 1.7bn) for its shareholders. This compares to a current market cap of GBP 1.56bn / USD 2.12bn.

Source: Jefferies, 2 November 2021

Conclusion - the market is discounting too much: The modelled value of the non-YPF portfolio plus performance fees is c. $3.8bn. Subtracting gross debt (cash roughly covers current definitive commitments) and three years' costs would reduce that figure to $2.2bn, roughly the current market cap, implying no growth and that the YPF cases are lost.

Not included in such a scenario are any proceeds from the YPF case. These would come on top and could range from 0 to several billion dollars. In fact, the payoff from the YPF case alone could be higher than the current market cap of Burford Capital and possibly up to twice the current market cap – which is insane! (Personally, I'd nail my colours to the mast with an estimate of a settlement or sale of the claim around the USD 2.5bn mark, which is slightly above the current market cap.)

Needless to say, Burford Capital isn't going into liquidation. The company is worth a lot more as going concern, and this calculation underestimates its intrinsic value.

With its track record, team, client relationships, co-investor relationships, fund management business, and brand value, Burford Capital should be able to grow significantly in the future. As a growth business and platform, it has value over and above its liquidation value.

A free 20-page analysis of Burford Capital by a blogger – excellent piece and recommended reading (source: Travis Wiedower, 20 April 2021)

Travis Wiedower

Burford Capital is By Far the Most Undervalued Company I Know Of

APRIL 20, 2021

Burford Capital is the largest legal finance company in the world. While Burford is mostly known for funding lawsuits, they provide legal capital in a variety of ways. In the simplest example though, Burford funds a plaintiff's lawsuit by paying their legal expenses. If the case is lost, Burford loses their entire investment. If the case is won, the plaintiff pays Burford a share of the winnings. I believe there are numerous benefits for plaintiffs to get funding from a company like Burford.

At a high-level, litigation funding can flatten the legal playing field. Lawsuits are expensive. Many legitimate lawsuits are never filed because the potential plaintiff cannot—or does not want to—pay for the legal expenses. Plaintiffs often do not like the traditional hourly billing model that many law firms operate on. But working with a litigation funder allows a plaintiff to exchange having to pay their own legal expenses for a percentage of their winnings if the case is victorious. To date, many plaintiffs have welcomed this trade-off of less downside, less upside, and more flexibility.

In addition, much of Burford's client base is large corporations, many of them public. For corporations, legal costs are expensed immediately and usually fall under selling, general, and administrative expenses on the income statement. Litigation funding allows corporations to move legal costs off their financial statements, decrease operating expenses, invest that cash elsewhere, and still benefit in most of the upside.

Finally, Burford has a lot of knowledge that can be valuable to a legal team. Burford has been in business since 2009 and they have been involved in well over a thousand legal claims. They have been successful by being picky in the cases they choose to fund. If Burford wants to invest, this adds an element of independent validation to a plaintiff pursuing a claim. And the plaintiff's chances of winning can increase by having Burford's expertise on their side.

In addition to being a win-win for Burford and their clients, I also believe Burford has a strong advantage in this burgeoning industry. By my estimate, Burford has around 30-40% market share and is more than twice the size of the second largest litigation funder, Harbour Litigation. It is difficult to get more precise numbers because most competitors are private and, as the industry is relatively young, there is not much independent third-party data available.

Nonetheless, this scale results in several advantages. First, Burford has little competition in the largest deals. Their market share may be 30-40% of the overall industry, but I suspect as deal size increases, Burford's market share rises to a large majority. Burford's average investment is over $20

How big is the potential market that Burford Capital can address?

This is a difficult, but interesting question.

Estimating the total addressable market

The sector of litigation finance is small and opaque.

There are only three publicly listed companies in the space. Besides Burford Capital, the only other one even worth mentioning is Australia's **Omni Bridgeway** (ISIN AU0000082489). With USD 2.4bn of assets, it is about half the size of Burford Capital, and in terms of market capitalisation, it's about one third the size of its British equivalent. Germany's **Foris** (ISIN DE0005775803) has been around for over two decades, but at EUR 15m market cap, it's barely a footnote within its own industry.

Digging around, I found there are around 20 well-known names in the industry, including:

- Augusta Ventures (UK): GBP 600m in litigation funding outstanding
- Balance Legal Capital (UK): GBP 250m in litigation funding outstanding
- Calunius Capital (UK): GBP 200m in litigation funding outstanding
- Harbour Litigation Funding (USA): USD 1.5bn in litigation funding outstanding
- JuraPlus (Switzerland): "*Switzerland's leading litigation funder*", no assets disclosed
- Juris Capital (USA): no assets disclosed
- Lake Whillans (USA): probably in the hundreds of millions dollars
- LCM (Australia/UK): no financial data available
- Liesker Procesfinanciering (Netherlands): no assets disclosed
- Longford Capital Management (USA): no assets disclosed
- Parabellum Capital (USA): "*hundreds of millions dollars*"
- Redbreast Litigation Finance (Netherlands): no assets disclosed
- Redress Solutions (UK): "*aggregate claim value in the hundreds of US$ millions*"

- Therium (UK): USD 1.1bn in litigation funding outstanding
- Vannin Capital (UK): purchased by Fortress in 2019, no data available

Without a doubt, there will be some names I have forgotten. A few hedge funds and investment banks will be operating litigation finance funds without talking about it in public.

To the best of my knowledge, just three of the names listed above have more than USD 1bn in assets under management: Longford Capital Management (USD 1.2bn), Harbour Litigation Funding (USD 1.5bn), and Therium. Also, some of the names listed above will not be pure-plays on litigation finance and as such lack the single-minded focus that a company like Burford Capital has in its business model.

It is difficult to quantify the legal market because it is highly fragmented. In the US, each state has its own laws and legal system as well as a federal system. Europe is similarly patchy. Although all judgments are of course recorded, no jurisdiction publishes (or appears to gather) detailed information about the financial outcomes of matters, and in any case, those settled out of court would not be captured.

A 24 October 2021 article by *Legal.io* tried to get a handle of the overall size of the legal market:

"*The global market for legal services encompasses all transactions for legal services worldwide. In 2021, some sources estimated this market at around $767.1B globally.*

...

To put that into perspective:

- *The global pet food market is estimated at around $75 billion in 2021.*
- *The global market for iPhones, based on 2020 sales, was $138 billion.*
- *The global tourism industry is estimated at $1,541 billion.*

The United States is by far the largest distributor of legal services globally, with some estimates pegging the US total market size at $437 billion, over half of the total global market size."

According to the *Global Arbitration Review*, the total value of pending arbitration cases at the top 30 law firms is over USD 2tn.

There is no market for litigation funding *per se*, but comparing the amount of litigation funding to the overall revenue of the legal market and the size of the US arbitration market yields an initial clue. All litigation funders together would probably struggle to reach USD 15bn in assets. There are a number of different estimates floating around for the industry, some of which are based on different ways of measuring its size. These estimates range from USD 11.3-39bn, as shown by this excellent 15 November 2021 article in *Bloomberg*. When measured based on Burford Capital's methodology, USD 10bn-15bn is the right range.

Only a small percentage of lawsuits lends itself to litigation funding, but there is also a large number of legal issues in the world that never make it to court because the plaintiff doesn't have the financial resources to pursue the case. As such, the mere availability of litigation funding will, over time, increase the size of the total addressable market.

With that in mind, it's probably fair to say that the overall market has the potential to keep growing at double-digit rates for many years to come. In any case, the market size will not act as a constraint on growth.

Even once you factor in crowdfunding platforms and specialist funds operated by investment banks and hedge funds, you probably wouldn't get past 50 industry participants. This compares to 8,000 private equity companies globally. Back in the 1980s, there were only a handful of private equity companies. Litigation funding will never reach the vast size that private equity has grown to, but it has all the hallmarks of an industry that can grow by a multiple over the next 10-20 years.

At the centre of it is Burford Capital as the company with the largest market share and the highest amount of assets under management. It is also the only company that has access to stock market financing both in the US and the UK, i.e. it can access the two deepest pools of capital in the world.

What's it worth to have such a growth platform available to yourself? It is certainly worth more than zero that the stock market is currently valuing.

Source: *Bloomberg*, 15 November 2021

Funds Have Made Lawsuit Bets Into a $39 Billion Sector

- Litigation funding is top draw for firms seeking high yields
- Legal assets seen as way to diversify risks in hard times

By Ellen Milligan and Katharine Gemmell
15 November 2021, 10:00 CET *Corrected 16 November 2021, 14:57 CET*

Hedge funds, private equity and sovereign wealth funds are piling billions into the outcome of high stakes court cases at a faster rate than ever before.

What are the risks?

Burford Capital is both a complex and a simple company to analyse.

While many still ask about the Muddy Waters affair, the real risks for Burford Capital's business probably lie elsewhere.

Key man risk: senior management and other staff are central to Burford Capital's ongoing success; losing staff (for whatever reason) would leave the company vulnerable.

Currency risk: Burford Capital tends to have the majority of its income in US dollars, but its operating expenses are predominantly in pound sterling. The company does not hedge against this risk.

Regulation: litigation finance is highly regulated, and it could be made illegal in some jurisdictions or otherwise restricted.

Competition: other players, possibly with deeper pockets, could enter the market. Law firms could set up their own litigation funds instead of referring business to external financiers.

Duration of cases: individual cases can drag on a lot longer than expected; Burford Capital currently still has a case that dates back to 2010.

I believe these risks have been mitigated to the degree they can be mitigated.

Key man risk: all staff own stock, and Burford Capital has a track record of retaining staff.

Currency risk: this will work against the company at times but in its favour at others. In the long run, this is likely to be balanced.

Regulation: The European Union is currently looking into litigation finance, but the strong lobby of corporates in Brussels would prevent a banning of the industry and instead the review will likely result in an increase in transparency. In the US, too, the legislator might introduce increased requirements for disclose. Overall, the trend globally is towards liberalising rather than restricting legal markets because of the obvious value the industry creates – including levelling the playing field for the little guy being able to bring cases that they could not afford otherwise.

Competition: private equity companies and investment banks such as Goldman Sachs will be reluctant to form litigation finances businesses, because they would end up suing some of their own clients. Law firms, in turn, operate as partnerships that distribute profits to their partners each year. They would struggle to add a fund management business on top of such partnerships. There is a reason why it hasn't happened yet.

Duration of cases: Burford Capital has built a diversified portfolio of claims.

On the whole, this business seems to stand on a pretty secure foundation.

You be the judge

I believe that Burford Capital has many advantages that will ensure it remains competitive:

- Scale, which is critical for diversification and effective portfolio management.
- A large and experienced team.
- A long track record.
- A well-known brand.
- Valuable complementary services, such as asset recovery.

Crucially, there are a few catalysts on the horizon that should help the stock get under steam again during the remainder of 2022. These include:

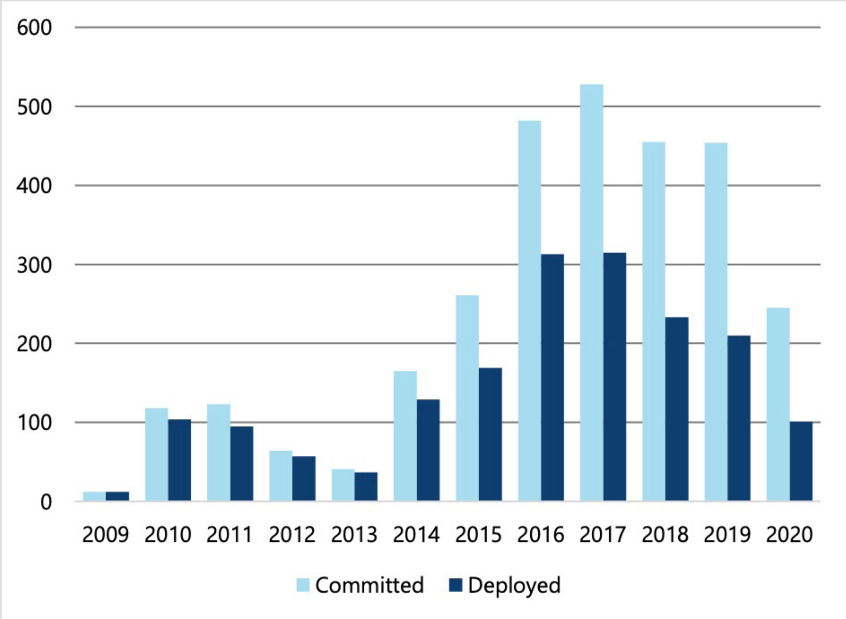
- Several of its best vintage funds are reaching maturity, and their "European waterfall" performance fee structure backloads performance fees (see chart on page 36).
- The end of the pandemic restrictions will unclog the court system and lead to overdue cases getting resolved.
- The market will realise that many of Burford Capital's funding contracts actually make for a higher share of the payoff in case of delays (making it a beneficiary of pandemic-related delays).
- Burford Capital's largest ever fund, a USD 1bn vehicle co-funded by a Sovereign Wealth Fund, will likely announce that it has fully deployed its capital.

Buying the existing portfolio below its liquidation value and getting all of these intangible assets for free on top is a risk/reward ratio that strikes me as favourable.

Adding the upside of the Petersen case on top of it all and valued at zero is insane, and all the more so since this case is heading to its final

Source: Jefferies, 25 July 2021

Exhibit 7 - Recent vintages are larger and less mature



Source: Jefferies, company data

stage during the second half of 2022. There is a risk of the case getting lost and the market reacting with disappointment and a sell-off, but ahead of that happening we are likely to see a renewed wave of speculation once a larger number of investors realises that this matter is now entering its final stage.

Scales are a symbol used for jurisprudence, but they could also be used as a symbol for evaluating investments. Weighing up all the factors, I think the scales tip heavily in favour of Burford Capital stock stating a new upward trend this year – or, at the very least, experiencing a short-term speculative uplift ahead of the Petersen case going to trial.

Needless to say, as ever, you need to draw your own conclusions from all this.

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