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Horrible Second Half Results Validate our Thesis

Burford's abysmal second-half performance speaks to the company's exaggerated marks, which are married to a flawed business model. Second half net realized gains were paltry, despite Burford seemingly having strong incentive to prove that it can monetize the investments on its ever-expanding balance sheet. Petersen accounted for approximately two-thirds of 2019 net realized gains. In other words, outside of Petersen, FY 2019 monetizations were dismal. This fact further illustrates the concentration of Burford's returns among a narrow range of cases.

Even more troubling is that Burford's late H1 sale of Petersen appears to have been anchored by one of the funds it manages. Some might wonder whether by moving some of the claim from the left hand to the right hand, Burford manipulated the market for the Petersen claim. That is compounded by doubts about a) whether the new Argentine government is interested in paying Burford, and b) whether Argentina may satisfy the claim by paying in Argentine pesos (or in a dollar amount significantly decreased by the peso's depreciation). Of course, Burford stubbornly refuses to disclose where it marked Petersen, which has become farcical with the realization that Burford has established the price at which it would both buy and sell the claim.

In Burford's August 2019 response to our initial report, it made a point that its liquidity was not at issue, claiming to have approximately $400 million of cash. We of course had questions about how Burford's cash balance had purportedly doubled in the short time since H1. Perhaps those questions are now moot, as Burford's FY 2019 cash balance is back in line with the much lower level as of H1.

Burford talked up its complex strategies on its February 3rd call. Just a few ironic hours later, a judge excoriated Burford's conduct of an appraisal rights claim against Perry Ellis in which Burford sought more than 2.5x the approved sale price. (The judge issued a declaratory judgment that Burford had no appraisal rights under the applicable statute.) This decision and the facts of the case give rise to various questions about how Burford marks appraisal rights claims and its competence in pursuing them.

Barely Existent H2 Net Realized Gains

H2 net realized gains were paltry, as they appear to be between only $1.9 million and $11.9 million. The poor nature of these results is likely why Burford buried this discussion in the middle of the press release. We believe it is fair to assume that Burford was under significant pressure to show it could monetize cases and justify its indebtedness – particularly when it stated in July 2019 that it had "unbridled optimism about the future".[1] Yet against this backdrop,

[1] Burford H1 2019 Report, p. 3

Burford failed to generate meaningful monetizations, and then management bizarrely announced its intention to raise more debt.[2]

H2 net realized gains appear to be only $1.9 million to $11.9 million. Burford disclosed that consolidated net realized gains for 2019 were approximately $20 million to $30 million lower than they had been in 2018.[3] The midpoint of that range equates to a YoY collapse of -85% in net realized gains for the second half of 2019. To put that in context, Burford's H1 2019 investment assets were 45% greater than at H1 2018.[4]

It is worth refreshing what the account "net realized gains" actually means. In our initial report, we explained that Burford was deceiving investors by conflating this account with a meaningless non-IFRS metric it created called "realized gains". Net realized gains is the amount of realizations, minus only the cash costs of the litigation. Net realized gains does not measure gains above the carrying values; therefore, positive net realized gains <u>do not</u> mean that Burford realized profits in excess of its carrying values.

Depending on where the accounts crystallize relative to the range given in the profit warning, investors can expect BUR's net realized gains in the second half of 2019 to be anything from slim to a virtual rounding error of approximately two million dollars.

Whither "Unbridled Optimism"?

	Consolidated B/S
2019E Net Realized Gains, Upper Bound ($mn)	151.5
Less H1 2019 Net Realized Gains	(139.5)
H2 2019E Net Realized Gains, Upper Bound	**11.9**
2019E Net Realized Gains, Lower Bound ($mn)	141.5
Less H1 2019 Net Realized Gains	(139.5)
H2 2019E Net Realized Gains, Lower Bound	**1.9**

Burford begs us to consider a supposedly phenomenal January 2020, but its language indicates that it intends to book significant unrealized gains during this month, rather than realized gains. This recalls Burford's discussion of its cash position this past August, which, as we discuss infra, was ephemeral. Regardless, the near absence of H2 2019 monetizations reinforces our concerns that Burford could have liquidity problems due to a mismatch of its (in our view, aggressively valued) assets and liabilities.

Burford's 2019 realizations would have been substantially worse absent the Petersen monetization, which accounted for approximately two-thirds of consolidated 2019 net realized

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[2] Burford 2019 Update on Trading Performance.
[3] We assume that Burford's net realized gains profit warning refers to the consolidated balance sheet, although BUR persists in sowing what we view as confusion by excluding third-party interests when it talks about "balance sheet".
[4] H1 2019 consolidated investments were $1,768.4 million, versus $1,218.0 million as of H1 2018.

gains. (Note that it constituted a higher portion of balance sheet net realized gains.) We have significant concerns about the June 2019 Petersen realization.

Unanswered Questions on Petersen Persist

As we discussed in August, there is a good reason to believe that Burford carries Petersen at close to the implied value of its June 2019 sale.[5] However, the sale price in this transaction is highly questionable, given that a Burford-managed fund appears to have been the buyer of 30% of this transaction. Chris Bogart seemed to confirm a Burford fund was the buyer on the company's February 3rd call, albeit through a predictably inscrutable thicket of legalese.

If a large chunk of the sale went to a Burford-managed fund, then Burford could have "painted the tape" and influenced the third-party buyers' valuations. Burford apparently views this as an attempt to "condition" the market – to us, it raises the specter of market manipulation.[6] We further note that the identities of the other buyers to whom Burford sold the Petersen claim continue to be unknown, and we have yet to encounter a buyer of the claim. Meanwhile, Petersen contributed approximately two-thirds of Burford's net realized gains in 2019 (using the midpoint of guidance).

Reliance on Petersen

2019E Net Realized Gains ($mn)	146.5
Less Net Realized Gains from Petersen, H1 2019	(98.2)
2019E Net Realized Gains ex-Petersen	**48.3**
Petersen Contribution to 2019 Net Realized Gain	**67.0%**

2019E figures calculated at midpoint of guidance

Even if the apparent purchase by a Burford fund did not set the price, and the buyers were highly sophisticated and experienced litigation claim investors, we wonder at what valuation Burford could now sell this claim. Since H1 2019, Argentina's government has reverted to the Peronists, who have a poor record of paying foreign creditors (to put it very mildly).[7] Moreover, we believe there is a valid question as to whether this claim – if Argentina chooses to satisfy it – would either be settled in Argentine pesos or in a US dollar amount that reflects the approximately 93% peso devaluation since the expropriation.

Beginning with our August 2019 report, we have been calling on Burford to disclose where it marks Petersen. This is critical because knowing the mark would allow investors to gauge a) earnings upside potential (i.e., how much of the future earnings power of the claim has Burford

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[5] "MW is Short Burford Capital", p. 16

[6] "The purpose behind that [secondary sales] is to condition the market." Chris Bogart remarks, February 3, 2019 Trading Update Call

[7] For one recent example, see https://www.wsj.com/articles/argentine-governor-rattles-markets-with-plans-to-delay-bond-payment-11579639842

already depleted), b) the magnitude of a potential impairment, and c) the gross fair value gains Burford took in H1 2019. We have maintained since then that management's excuse for not disclosing the mark – namely that doing so would compromise attorney-client privilege – is bullshit. Given that Burford was likely on both sides of the latest transaction, this excuse is even more difficult to take seriously.

Burford has fiduciary duties to both its public company (i.e., balance sheet) shareholders and its fund limited partners. It would seemingly risk a shareholder duty to sell the claim for materially less than what Burford thinks it is worth. By the same token, it would seemingly risk a violation of its duties to LPs to pay materially more than what it thinks the claim is worth. In other words, Burford's apparent left hand to right hand transaction says more about Burford's valuation of the claim than disclosing its mark would. The mark is merely an accounting entry, and we continue to believe that Burford is snowing investors when it refuses to disclose it.

We reiterate our calls for Burford to disclose its Petersen mark, as well as its historical gross fair value gains by period.

Cash Depletion Deepens Questions About Liquidity

"Burford also has a strong cash position, with approximately $400 million in cash and cash equivalents on hand presently."—Response to Short Attack, August 8, 2019

Much of Burford's intra-period cash vanished without an explanation from management. In August, Burford claimed to have "approximately $400 million" of cash on hand, more than double the $171 million as of the H1 2019 balance sheet date. However, at year-end 2019, management conceded this number stood at $192 million. We question where over half of Burford's cash went, and we encourage investors to remain focused on cash on hand.

Potentially making this cash depletion even more significant was Burford's collection of 97% of the $173 million in H1 2019 investment receivables. If this collection occurred after Burford's statement about its approximately $400 million of cash, then investors should be even more concerned.

The return-challenged nature of Burford's business is clear: Even as the fair value gain-riddled balance sheet has more than doubled in size over the past two years, net realizations have grown by only 19%. These two factors made for BUR's worst year since 2014 on a cash-on-cash basis, with only 8.3% of investment carrying values turning into realizations (using the midpoint of guidance).[8]

[8] We refer to cash realizations, not Burford's "cash returns"

$millions	2012	2013	2014	2015	2016	2017	2018	2019E
Net Realized Gains (Consolidated)	11.8	6.5	12.0	60.4	47.5	122.7	171.5	146.5
Consolidated Carrying Value of Investments at Half Year	149.1	161.2	219.3	241.8	497.2*	750.6	1,218.0	1,768.4
Net Realized Gains as Percentage of Investments Value	**7.9%**	**4.0%**	**5.5%**	**25.0%**	**9.5%**	**16.3%**	**14.1%**	**8.3%**

** As restated*

With cash levels well below what BUR had previously characterized as a "strong" cash position, poor cash realizations, and escalating funding obligations, it is no coincidence that BUR aims to raise even more debt in 2020. In our view, although Burford is merely adding further strain to the company's weak cash generation, it might really have little choice.

"Had January's Events Occurred in December…"

Playing hide-the-ball with cash balances was nice while it lasted, but we note it was the previous period's game. This time around, after disclosing virtually nonexistent H2 2019 realizations despite a record balance sheet size, management began discussing its purportedly bountiful January in place of the usual saccharine "year in review". We remind Burford that, to our knowledge, its fiscal year is a twelve-month period ending December 31. However, the key language here is the qualification that these are unrealized gains that "if ultimately affirmed and paid…" We recall an adage about the condition under which one's grandmother would instead be the grandfather.

And If February were January… Denying Appraisal Rights in Perry Ellis a Few Ironic Hours Later

"They [Burford] gambled on an ability to leverage a buyout from Perry Ellis at a price above the merger consideration… They lost that gamble." Judge Michael Hanzman, February 3, 2020[9]

On February 3rd during US business hours, Burford suffered an embarrassing setback in its complex strategies. In a summary judgment, a Florida court issued a declaratory judgment that Burford had invalidly attempted to exercise appraisal rights in the sale of Perry Ellis to its founder. Burford purchased Perry Ellis International shares in 2018, beginning approximately one month after the record date for eligibility to vote on the sale. Burford sent Perry Ellis an appraisal rights notice, demanding a per share price that was more than 2.5x the acquisition price. This would have represented a premium of approximately $70 million.[10]

The most obvious question raised by these facts is to what extent Burford takes fair value gains on appraisal rights claims. The next level of concern has to do with the impact such appraisal rights claims have on Burford's financial statements. The buying of securities should increase

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[9] *Perry Ellis International v. BCIM Strategic Value Master Fund, LP, et al.*, 2018-42775 CA 01, Final Summary Judgement, p. 29
[10] *Perry Ellis International v. BCIM Strategic Value Master Fund, LP, et al.*, 2018-42775 CA 01, Final Summary Judgement, p. 5

the cash flow statement cash outflows for Funding of investments, and the sale of securities should increase the Proceeds from investments. The net effect is to once again obscure core litigation financing performance. This result also supports our view that Burford emphasizes quantity over quality in making investments: the dicta—if not the fact of summary judgment—in the court's decision indicates that it believed it was obvious Burford was not entitled to appraisal rights, given the timing of its share purchases. (Moreover, the decision hints that it might order Burford to pay attorney's fees to Perry Ellis.)

We call on Burford to disclose the history of its fair value gains from appraisal rights claims, and the results of such claims relative to the marks.