Muddy Waters Capital LLC
info@muddywatersresearch.com
Director of Research: Carson C. Block

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Report Date: August 7, 2019 **Company**: Burford Capital Ltd. **Ticker:** BUR LN **Industry**: Specialty Finance	**Stock Price:** £11.21 **Market Cap: £2.45 billion** **Float**: 91.8% **Average Daily Volume (30-day)**: £11.63 million

"*We have repeatedly commented on the increasing complexity of Burford's investment transactions, and the Jaguar investment is an example of both investment and accounting complexity – but also an illustration of our success in turning complexity into profit*."[1]

(Readers of this report will likely come to view this statement as stunningly brazen.)

Introduction

We are short BUR. For years, it was the ultimate "trust me" stock. Thanks to a light disclosure regime, the esoteric nature of its business, and unethical behavior by its largest shareholder, Invesco, it turned Enron-esque mark-to-model accounting into the biggest stock promotion on the AIM. This has all recently changed though. Just this year, BUR began publishing more detailed investment data. This data proves that BUR has been egregiously misrepresenting its ROIC and IRRs, as well as the state of its overall business.

BUR's top management, through their shareholdings (and sales), is in effect primarily compensated for aggressively marking cases in order to generate non-cash fair value gains. We calculate that as of H1 2019, fair value gains constituted 53.9% of balance sheet core litigation assets (up from 47.4% as of December 31, 2018). Until now, BUR has gotten away with aggressive and unwarranted marks by touting ROIC and IRR metrics. We show that BUR heavily manipulates these metrics. BUR then actively misleads investors about how its accounting for realized gains works. As a result of this deception, we believe investors give credence to BUR's fair value gains. We believe that at least 72% – and possibly as much as 90% – of H1 2019 Total Investment Income was really from Fair Value Gains. (BUR's Investment Income shows Fair Value Movements were 55.1% of Total Investment Income during the period.)

In actuality, BUR's net realized returns have relied on a very small number of cases. Just four cases have produced approximately 66% of BUR's net realized gains during 2012 through H1 2019. We calculate that the other concluded cases during this time generated a combined ROIC

[1] Burford Capital 2017 Annual Report, p. 23.

of only approximately 19%. (One of the four outsized contributors was actually a loss a trial, and was bailed out by BUR's largest shareholder, Invesco, at the direction of Neil Woodford protégé Mark Barnett. Absent the bailout, the case almost certainly would have been a total loss.) The reality of BUR's dependence on a small number of cases for the bulk of its returns is in stark contrast to the impression many investors seem to have that the portfolio produces meaningful returns across its breadth.

BUR's liquidity is risky, and it is arguably insolvent. We believe that BUR's "real" invested capital is $880.3 million. BUR's massive operating expenses tax that at approximately 9%, based on LTM expenses. BUR's financing costs (including dividends) add another 8.3%. Therefore, in our opinion, the first approximately 16.5% of returns BUR's adjusted investment capital generates goes to keeping the lights on. BUR is arguably insolvent, as its debt and funding commitments greatly exceed the $880.3 million adjusted invested capital.

BUR is a perfect storm for an accounting fiasco. It is a fund that invests in an illiquid and esoteric asset class, which few investors can understand well. By remaining listed on AIM despite being a midcap company, the company's disclosure requirements are lighter than they would be for the main board – and far lighter than they should be. By choosing to account for its litigation investments as financial assets, BUR utilizes fair value accounting for a balance sheet largely comprised of Level 3 fair value assets (i.e., "mark to model" accounting of Enron fame). BUR disingenuously blames IFRS for needing to take (outsized) fair value gains when in fact, it was BUR's choice to adopt this accounting.

BUR's governance strictures are laughter-inducing. The CFO is the wife of the founder / CEO. Under the best of circumstances, this should alarm investors; however, with a company that consistently books non-cash accounting profits, it is unforgivable. In a situation so ripe for abuse, the very least the company could do is to have an independent CFO. (The CEO has sold a total of £59.4 million of stock.) BUR has cycled through four prior CFOs or senior finance managers (none of whom stayed for long). The table below shows the turnover at CFO and senior finance functions. These facts beg the question "Is Elizabeth O'Connell the only CFO who can be relied upon to approve the accounts?"

Name	Appointed	Resigned	Role
Miriam Connole	2013	2014	CFO
Jeremy Garber	2014	2015	COO and head of CFO function
Jamie Knowles	2013	2016	Head financial controller
Therese Stroch	2017	2018	CFO of Burford Investment management
Elizabeth O'Connell	2017	Present	CFO (Wife of CEO)

The directors have each served on the board approximately 10 years, and per the UK Corporate Governance code, are no longer considered independent. (In a bizarre defense of worst practices, BUR recently pointed out that it is not subject to the governance code, and thus sees no need to change the board.[2]) After spending $160 million to buy a litigation fund management

[2] BUR H1 2019 Interim Report, p. 14.

business, Gerchen Keller, and entering into employment and non-compete agreements with its principals, those principals left to start a law firm that focuses on taking cases on contingency.[3] We cannot help but feel that BUR had ulterior motives for this acquisition, such as to consolidate assets in order to make its debt load look less ominous, or to ensure it is valued as an operating business, rather than as a closed-end fund. BUR has issued $646.9 million of retail bonds, and yet has no credit ratings.

Summary

We are short BUR because it is a poor business masquerading as a great one. BUR woos investors with non-IFRS metrics, particularly IRR and ROIC.[4,5,6] However, these metrics are meaningless. They are heavily manipulated and greatly mislead investors about BUR's actual returns. We have identified seven techniques through which BUR manipulates its metrics to create what we believe is an egregiously misleading picture of its investment returns. These manipulations usually involve BUR either giving itself credit for a recovery when one is uncertain (or even highly unlikely) or ignoring cases that are likely to be failures. The manipulation techniques are: 1) categorizing a loss as a win, 2) counting as "recoveries" awards or settlements with uncertain to highly unlikely collections as equivalent to cash returns when calculating IRR, 3) misleadingly representing investments that BUR inherited from acquisitions as favorable IRR, 4) choosing its own cost denominator in a case with a recovery when the total cost is much greater, 5) delaying recognizing a trial loss for two years, 6) keeping trial losses out of the "Concluded Investment" category, and 7) failing to deduct various costs against recoveries, including the very operating expenses associated with the investments themselves.

It is only since BUR finally provided an investment data table in H1 2019 on its website that it has now become possible to analyze individual cases and understand how misleading BUR's presentation of returns is. Through analyzing these cases, we were able to identify these various manipulation techniques.

BUR also reinforces the misperceptions that its fair value gains are prudent by very cleverly conflating two distinct concepts: Realized Gains and *Net* Realized Gains. BUR's total investment income generally shows a roughly 50/50 split between Net Realized Gains and Fair Value Movements. Net Realized Gains actually include previously recognized Fair Value Gains. In other words, a Net Realized Gain is Proceeds minus BUR's invested capital in the case – not minus the investment's Carrying Value. We think the vast majority of investors believes the opposite is true – that Net Realized Gains are Proceeds minus the Carrying Values.[7] To the extent we are correct that most investors misunderstand Net Realized Gains, it is because BUR deliberately misled them.

In reality, significant Net Realized Gains do not imply that BUR's Fair Value Gains are in fact conservative. Even more problematic is that when BUR books a Net Realized Gain that includes

[3] http://www.lawdragon.com/2018/11/28/the-disruptors-keller-lenkner-moves-from-legal-finance-to-practicing-law/
[4] March 16, 2018 sell-side report, p. 7
[5] October 2, 2018 sell-side report, p. 1
[6] January 3, 2019 sell-side report, p. 3
[7] Our perception is based on reading sell-side research and investor-published research pieces on BUR.

a previously booked Fair Value Gain, to balance out the accounts, an amount equal to the previously booked Fair Value Gain is deducted from the current period's Fair Value Movements.

BUR has been highly reliant on only four cases for its monetizations, showing that its broader portfolio has lacked strength. Through manipulating ROICs and IRRs, BUR portrays itself as a business that derives profits from a broad range of cases in its book. The reality is that BUR's profits are much more concentrated, and have really been dependent on just four cases that have generated approximately two-thirds of its net realized gains since 2012. We calculate that during this time, the remainder of the Concluded Investments generated a combined ROIC of only approximately 19%.

BUR appears financially fragile. BUR's operating expenses, financing costs, debt, and funding commitments, in our view, put it at high risk of a liquidity crunch. BUR is already arguably insolvent. We believe BUR's "real" invested capital is $880.3 million. In our view, this adjusted capital needs to generate returns that fund operating expenses equal to approximately 9% of its balance, along with another approximately 7.5% of financing expenses. We believe that these cash needs are why BUR frequently raises capital. BUR's debt and litigation commitments together dwarf this adjusted capital base, meaning BUR could be viewed as insolvent.

Manipulation of Performance Metrics

By analyzing individual cases, we identified seven techniques that BUR has used to manipulate its performance metrics. Those methods are: 1) Categorizing a loss as an investment with a significant return, 2) counting as "recoveries" awards or settlements with uncertain to highly unlikely collections as equivalent to cash returns when calculating IRR, 3) representing an investment that BUR inherited when it acquired GKC in a way that misleadingly significantly boosted claimed returns, 4) choosing its own cost denominator in a case with a recovery when the total cost is much greater, 5) delaying recognizing a trial loss for two years, 6) keeping losses out of the "Concluded Investment" category, and 7) failing to deduct the costs of making and maintaining litigation investments against associated recoveries, which are approximately 9% on a LTM basis of BUR's adjusted invested capital.

#1 Categorizing a Loss as an Investment with Significant Return

BUR's reporting of Napo Pharmaceuticals Inc. v. Salix Pharmaceuticals Inc. ("Napo", BUR case no. 111290) should make BUR investors want to take a shower.[8] (This is the case referenced in the quote about 'Jaguar' at the beginning of this report.) The simplest problem is that BUR actually categorized it as a Concluded Investment in 2013. However, the case did not reach a verdict until 2014. BUR's 2013 annual report showed the case generated a positive ROIC of over 100%, but the 2014 verdict was a complete loss for BUR's client, Napo. These events were just the tip of the iceberg however. BUR's largest shareholder helped lead a bailout of the investment, which led to BUR preserving – and then actually increasing – this illusory return. (BUR finally trued up Napo around the time it issued its H1 2019 interim report.)

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[8] *Napo Pharmaceuticals, Inc. v. Salix Pharmaceuticals, Inc.*, Index No. 651214/2011, New York County Supreme Court of the State of New York

Napo is a stranger-than-fiction example of manipulating performance and profit metrics. Not only do we view BUR's management as having acted highly unethically in this instance, but we also see Invesco fund manager Mark Barnett as having been equally complicit in ways reminiscent of some of the highly aggressive marking value techniques he and Neil Woodford have employed together.[9] (Mr. Woodford's fund was the second-largest shareholder in BUR, next to Invesco, and Mr. Woodford is responsible for Invesco's initial investment in BUR.[10]) Through accounting sleight of hand, a cash investment partially provided by Invesco, and a reverse merger into a soon-to-collapse U.S. nanocap led by a highly questionable CEO, BUR turned a loss at trial into a purported 195% ROIC.

BUR first disclosed Napo as a "Concluded Investment" in its 2013 Annual Report, and claimed a total recovered of $15.8 million on a $7.4 million investment, which was purportedly a 113% ROIC.[11] However, the case had not yet concluded. It reached a jury verdict in 2014, and BUR's client, Napo, actually lost the trial when the jury returned a verdict in favor of Salix.[12]

In the 2013 disclosure, Napo was shown as the largest recovery from the 2011 vintage, which BUR calculated had generated a ROIC of 53%. Without the bailout of this case, BUR's 2011 Concluded Investment ROIC would have been only 2.9%. Given BUR's claim that litigation typically takes one to two years to generate returns, showing a 53% ROIC from the 2011 vintage must have helped to woo investors.

Concluded Investment Performance
($ million)

Vintage	Total investment	Total recovered	Return on invested capital	IRR
Investments made in 2011* – 53% complete	7.4	15.8	113%	104%
	3.5	6.4	83%	34%
	4.9	6.5	32%	29%
	10.0	7.5	(25%)	–
	4.4	–	–	–
	1.1**	11.8**	996%	311%
2011 Performance to date	**31.3**	**48.0**	**53%**	**31%**

Source: Burford Capital 2013 Annual Report, p. 11

The fact that Napo actually lost the trial in 2014 did not sour the company's view of its investment. Rather than reverse the gain, BUR actually marked the investment up *yet again* – to a ROIC of 189%.

9 See https://www.shareprophets.com/views/42931/video-tom-winnifrith-exposes-neil-woodford-back-in-april-2018-so-far-ahead-of-any-other-journalist
10 https://www.standard.co.uk/business/invesco-perpetual-ace-takes-up-major-chunk-of-burford-6768184.html
11 BUR 2013 AR, p. 11.
12 https://www.cov.com/files/Uploads/Documents/Salix_Wins_Jury_Verdict_In_Breach_Suit_Over_Napo_Drug.pdf

Concluded investment performance

$ in millions	Total investment	Total recovered	Return on invested capital	IRR
Concluded investments made in 2011* • 54% of vintage	5.5**	26.1	371%	124%
	7.4	21.3	189%	55%
	3.5	6.7	92%	34%
	4.9	6.5	32%	29%
	10.0	7.5	(25%)	0%
	4.0	0.2	(94%)	0%
	4.4	0.0	(100%)	0%
2011 performance to date	39.7	68.3	72%	27%

Source: Burford Capital 2014 Annual Report, p. 10

BUR apparently converted its investment into a debt of Napo totaling $30 million as of October 10, 2014. It appears that Napo was separately indebted to law firm Boies Schiller as well as several investment firm creditors.[13] The BUR debt was not repaid, and Napo and BUR's subsidiary, Nantucket Investments Ltd., entered into a debt forbearance agreement in December 2016 for what was then marked as a $52.8 million debt (including $729,000 of accrued interest).[14] Concurrent with the forbearance agreement, Napo took on additional debt from another fund that became senior to Burford's.[15] Napo appears to have been headed to bankruptcy, because as of December 31, 2016, it had $391,000 LTM revenue, an operating loss of -$4.1 million, cash of only $2.3 million, debt of $58.9 million, and a negative book value of -$58.9 million.

BUR's litigation investment needed a bailout by this time. Enter BUR's largest shareholder, Invesco, and its Invesco Perpetual Income and Growth Investment Trust plc and Invesco UK Strategic Income Fund, both managed by Mark Barnett.[16,17] Another Invesco fund, also managed by Mr. Barnett, the Invesco High Income Fund (f/k/a the Invesco Perpetual High Income Fund), is the largest shareholder of BUR.[18]

By getting involved with Napo and Jaguar, both Invesco and BUR had gone decidedly low rent. Napo was started by a Silicon Valley entrepreneur with a checkered history, Lisa Conte. For over a decade, Ms. Conte ran a company called Shaman Pharmaceuticals. Shaman initially promised cures for cancer and HIV before filing for bankruptcy in 1999.[19] Ms. Conte then started a dietary supplements company from the ashes of Shaman and, when that business failed, founded Napo in 2001.[20] In 2010, she told Forbes that she had burned through $200 million of

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13 Limited Subordination Agreement dated December 30, 2016, p. 1
https://www.sec.gov/Archives/edgar/data/1585608/000104746917002706/a2231655zex-10_49.htm
14 Napo Pharmaceuticals Settlement and Discounted Payment Agreement, p. 51.
https://www.sec.gov/Archives/edgar/data/1585608/000104746917002706/a2231655zex-10_52.htm
15 Limited Subordination Agreement dated December 30, 2016, p. 8.
16 https://www.invesco.co.uk/uk/products/perpetual-income-and-growth-investment-trust-plc
17 https://www.invesco.co.uk/uk/products/invesco-uk-strategic-income-fund-uk
18 https://www.invesco.co.uk/dam/jcr:17131d9a-2b71-4541-9e18-4e94ca47677d/GB00B8N46V79_EN_UK.pdf
19 Scott Fearon, *Dead Companies Walking,* pp. 102-103.
20 https://www.businesswire.com/news/home/20090203006008/en/Napo-Pharmaceuticals-Receives-Cornerstone-Investment-Crofelemer-Access

funding in her quest to make pharmaceuticals from rainforest medicines.[21] When Napo entered into the forbearance agreement with BUR, the plan was to merge Napo into another Conte-founded U.S.-listed entity, Jaguar Animal Health Inc.[22] The merger was completed July 31, 2017.[23]

The merger plan required Napo to pay BUR $8 million cash, and issue approximately 43 million Jaguar shares "as a compromise" to settle Napo's loan obligation.[24,25] The cash came from an equity raise Jaguar completed with the merger.[26] The Invesco Perpetual Income and Growth Investment Trust plc or Invesco UK Strategic Income Fund backstopped the financing, subscribing for 3,243,243 Jaguar shares for $3 million. All $3 million went "immediately" from the fund to BUR's subsidiary Nantucket. According to the Joint Merger Proxy Statement / Prospectus, the direct payment to Nantucket / BUR was an express condition of Invesco's investment.[27,28] Interestingly, Nantucket's address of record is listed as that of Invesco's global headquarters on Jaguar Health's 2017 proxy statement.[29]

We are unsure how the investment in Jaguar comported with the Invesco Perpetual Income and Growth Investment Trust plc's objective, which was "to provide shareholders with capital growth and real growth in dividends over the medium to long term from a portfolio of securities listed mainly in the UK equity market."[30] Given that one of Mr. Barnett's other funds was the largest shareholder of BUR, we assume this investment was made purely to perpetuate a mythical ROIC and IRR.

Regardless, this $8 million repaid the $7.4 million that BUR had invested, making the cash-on-cash ROIC approximately only 8.1%.[31] But while the cash-on-cash returns were anemic, there was still the value of the Jaguar shares that BUR received. For a minute anyway:

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[21] https://www.forbes.com/forbes/2011/0117/entrepeneurs-pharma-prescriptions-lisa-conte-mission-impossible.html
[22] Limited Subordination Agreement dated December 30, 2016, p. 1. https://www.sec.gov/Archives/edgar/data/1585608/000104746917002706/a2231655zex-10_49.htm
[23] https://jaguarhealth.gcs-web.com/news-releases/news-release-details/merger-jaguar-animal-health-and-napo-pharmaceuticals-effective
[24] Jaguar Health 2017 proxy statement, p. 43
[25] The share issuances to Nantucket are dependent on whether Jaguar's share price could satisfy certain hurdle rate returns. Given Jaguar's stock has done so poorly it has reverse-split 1 share from 1050 since the merger, we are skeptical that fewer than the maximum number of shares will be issued.
[26] Napo Pharmaceuticals Settlement and Discounted Payoff Agreement, p. 4
[27] Jaguar Health 2017 proxy statement, p. 45
[28] Invesco's agreed price per the March 31, 2017 merger agreement was $.925 per Jaguar share. Two months later, however, Jaguar executed a PIPE with a private investor that raised $50,000 at a mere $.50 a share. Source: Jaguar Health 2017 10-K, p. 92
[29] "The address for the reporting person is 1555 Peachtree Street NE, Suite 1800, Atlanta GA 30309." Source: Jaguar Health 2017 proxy statement, p. 7.
[30] https://www.invesco.co.uk/dam/jcr:c67d5aff-8962-43bf-936d-f6b24c930622/fncl-stmnt-it-pigit-halfyearly-2017.pdf
[31] $8.0 million / $7.4 million.

As shown above, the highest Jaguar's stock has traded since the merger was the day immediately following it. By the end of 2017, Jaguar had declined 76.2% from August 1, 2017. BUR, which was restricted from selling the vast majority of the shares and had unrealized losses on the stock of $6.95 million by the end of 2017, took yet another markup on Napo to a ROIC of 195%.[32,33] Rather than writing down the recovery from the case, BUR reported the loss as a "net loss on equity securities", making it highly likely that few – if any – investors ever became aware that the reported ROIC and IRR of Napo was a sham.[34]

Burford

BURFORD CAPITAL INVESTMENT DATA

All figures in US$ millions unless marked otherwise

INVESTMENT DEMOGRAPHICS					INVESTMENT SUMMARY										BALANCE SHEET		
Vintage Status Structure	ID	Type	Industry	Geography	% of Vintage	Original Commit	Follow-on Commit	Total Commit	Total Deploy	Total Recover	ROIC	IRR	Weighted Average Duration	Simple Duration	BS Commit	BS Deploy	BS Recover
Litigation Finance																	
2011					100.0%	116.1	7.5	123.5	95.4	86.7					123.5	95.4	86.7
Concluded					71.1%	84.4	3.4	87.8	59.7	85.3					87.8	59.7	85.3
Single Case																	
	111018	Business Torts	Diversified Financials	North America	3.2%	4.0		4.0	4.0	0.2	-94%	0%	3.0		4.0	4.0	0.2
	111027	Business Torts	Software & Services	North America	4.0%	4.9		4.9	4.9	6.5	32%	29%	1.4		4.9	4.9	6.5
	111085	Contract	Commercial & Professional Services	North America	3.6%	4.5		4.5	3.5	6.8	93%	34%	2.4		4.5	3.5	6.8
	111194	Business Torts	Energy	North America	6.5%	8.0		8.0	3.7	0.0	-100%	0%	6.2		8.0	3.7	0.0
	111255	Contract	Materials	North America	4.9%	6.0		6.0	3.6	0.0	-100%	0%	3.1		6.0	3.6	0.0
	111265	Contract	Media & Entertainment	North America	8.1%	10.0		10.0	10.0	7.5	-25%	0%	1.6		10.0	10.0	7.5
	111290	Contract	Pharma, Biotech & Life Sciences	North America	6.1%	4.5	3.0	7.5	7.4	21.8	195%	24%	4.7		7.5	7.4	21.8
	111348	Contract	Health Care Equipment & Services	North America	3.6%	4.5		4.5	4.4	0.0	-100%	0%	0.7		4.5	4.4	0.0

32 Burford Capital 2017 Annual Report, p. 24
33 Jaguar Animal Health Merger Agreement filed March 30, 2017, p. 11-12
34 Burford Capital 2018 Annual Report, p. 65

BUR was able to sell very little of its share grant. Over 40% of the shares issued were subject to a minimum share price condition, which fast-declining Jaguar stock tripped before the ink had even dried on the merger.[35] Another 45%+ of the shares were to be held in escrow for three years subject to certain conditions.[36] Both equity tranches are now basically worthless.

What remainder BUR could dispose of, it did, netting ~$600,000 in September 2018.[37] This sum was, however, a far cry from the payouts of up to $45 million that had been discussed in the company's agreement with Jaguar a year and a half earlier.[38] At some point after April 2019 – seven years after the litigation funding, BUR finally trued up Napo in the Concluded investment table. Without any fanfare or announcement, the table now shows a ROIC of 18% and an IRR of 3%.[39] With Jaguar's entire market cap sitting at $5 million and having had its equity diluted four separate times, BUR finally decided to reduce its recovery for the matter, explaining that "the stock has underperformed and we have concluded we would not be able to sell it for much".[40]

Without the Invesco-led bailout, Napo likely would have been a total loss. We believe BUR investors have been bamboozled by the company and Invesco.

<u>#2 Counting as "Recoveries" Awards or Settlements with Uncertain to Highly Unlikely Collections as Equivalent to Cash Returns when Calculating IRR</u>

BUR's IRR calculation, which is a significant factor underpinning investors' enthusiasm for the stock, depends on three factors: The amount recovered, the amount deployed, and the timing of recovery. In this report, we challenge the amounts recovered and deployed (in terms of what BUR includes in its Concluded Investments); however, we see that BUR has misleadingly boosted its IRR numbers by deeming amounts recovered when in reality they were years away from collection. BUR has also deemed patents that it subjectively valued as recovered amounts, which unsurprisingly, resulted in a downside reassessment after deeming the case concluded.

BUR showed a counterclaim from *Desert Ridge Community Association,* et al. *v. City of Phoenix,* et al. ("Desert Ridge") as a Concluded Investment in its 2013 annual report.[41] The problem is that BUR showed an IRR of 51% as of 2013.[42,43] However, payment was contingent upon BUR's client, counterclaimant Gray Development, selling off a parcel of real estate. In 2016, with the land unsold, BUR sold the promissory note entitling BUR to its portion of the

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[35] Investor Rights Agreement between Jaguar Health and Nantucket Investments, p. 4
https://www.sec.gov/Archives/edgar/data/1585608/000104746917002234/a2231636zex-10_1.htm
[36] Investor Rights Agreement, p. 12
[37] https://www.sec.gov/Archives/edgar/data/1585608/000090266418003807/xslF345X03/ownership.xml
[38] Investor Rights Agreement, p. 3
[39] Per the Concluded investment table shown on BUR's website (accessed August 4, 2019)
https://www.burfordcapital.com/investors/investor-information/concluded-investment-performance/
[40] Burford Capital 2019 Interim Report, p. 8
[41] Burford Capital 2013 Annual Report, p. 11
[42] Burford Capital 2013 Annual Report, p. 11
[43] Burford Capital 2014 Annual Report, p. 10

potential proceeds at a steep discount. The new buyer, a rival real estate developer, foreclosed on the property and plunged Gray into bankruptcy.[44]

As a result of BUR's actions years after the conclusion of the investment, Gray's bankruptcy estate is now suing BUR for violating its "duties of good faith and fair dealing", alleging the note sale sent a signal to the market that Gray was not able to find a buyer for the property.[45] BUR has adjusted down IRRs on Desert Ridge to 47% today.[46] However, BUR has not acknowledged the significant contingent liability that accompanies this lawsuit, in which Gray's bankruptcy estate claims more than $200 million in damages. Final recoveries remain uncertain more than six years after Desert Ridge was concluded.

In a separate case, in H1 2019 (case 122094), BUR disclosed a perplexing scenario in which it had received as proceeds certain intellectual property "that was dependent on the inventor's continuing activities".[47] The inventor died, and according to BUR, it had to write down the recovery in the associated case by $3 million. Whether this tragic event was foreseeable or not is impossible to gauge, but the fact that BUR received a non-cash recovery with a subjective valuation does not inspire confidence in the caliber of said "recoveries".

<u>#3 Misleadingly Representing an Investment that BUR Inherited through Acquisitions as Favorable IRR</u>

BUR calculates gains from proceeds received from cases brought in with acquired businesses, yet the calculations ignore the consideration BUR paid to acquire the firms and their portfolios. Failing to allocate a portion of the purchase price to these cases results in higher ROICs and IRRs. BUR acquired asset recovery business Focus Intelligence Limited in January 2015, and an attendant Legal Services case (Case Number 154586) is shown as generating $4.9 million on a $2.2 million investment, with an ROIC of 186% and an IRR of 138%.[48] However, BUR excludes the $1.5 million spent to acquire Focus Intelligence in the first place.[49] Because the acquisition was essential to putting the case on BUR's balance sheet, a portion of the purchase price should be included in the investment denominator.

BUR's behavior in a bankruptcy case interest it acquired via the Gerchen Keller Capital acquisition, *Magnesium Corporation of America,* et al., ("MagCorp"), demonstrates another instance of BUR's manipulating investment costs. In 2017, pursuant to a judgement in favor of the bankruptcy estate, BUR booked an ROIC of 93% and an IRR of 75% on the investment.[50,51,52] BUR makes no adjustment for the allocation of the $160 million purchase

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[44] https://azbigmedia.com/real-estate/big-deals/heres-how-crown-realty-got-121m-worth-of-prime-land-for-54m/
[45] The accompanying case is *Epicenter Partners LLC et al. v. Burford Capital Limited et al.*
[46] Burford Capital Investment Data, Case 111061
[47] Burford Capital 2019 Interim Report, p. 8
[48] Burford Capital Investment Data, Case 154586
[49] Burford Capital 2015 Annual Report, p. 27
[50] https://www.reuters.com/article/us-rennert-decision/billionaire-rennert-must-pay-213-2-million-judgment-u-s-appeals-court-idUSKBN16F25K
[51] https://www.law360.com/articles/945802/renco-loses-challenge-to-trustee-s-sale-of-26-2m-stake
[52] Burford Capital Investment Data, Case 177517

price of Gerchen Keller to Gerchen Keller's $15.0 million investment cost. Against a recovery of $28.9 million, allocating even $3 million from the purchase price would drop the ROIC to 63%. Viewed from the context of any reasonable apportionment of the acquisition cost, MagCorp returns would not appear as stellar.

Furthermore, after buying Gerchen Keller, BUR made further investments in the MagCorp case from its own balance sheet ("MagCorp BS"). However, BUR marked this balance sheet investment separately, starting from the date of the Gerchen Keller acquisition. This maneuver allowed the company to report a MagCorp BS ROIC of 92%, similar to the original, but with a higher IRR of 107%.[53] BUR would quite possibly have been unable to gain a late entrée into funding the MagCorp case but for purchasing Gerchen Keller. By not only excluding any acquisition costs, while also cherry picking the investment start date in an arbitrarily separate investment, BUR again manipulated its ROICs and IRRs.

#4 Choosing its Own cost Denominator When the Total Cost is Much Greater

BUR selectively sets the denominator in its returns calculations, allowing it to overstate IRRs and ROICs by understating historical expenses or ignoring future funding needs. In 2018, BUR financed oligarch divorcée Tatiana Akhmedova, who was trying to collect on a 2016 award exceeding $500 million. BUR's lump sum payment to her of at least $18 million has been useful, helping defray her living expenses.[54]

At year-end, BUR recorded $5.2 million of partial recoveries in this case.[55] However, these recoveries came not against the $18.0 million of deployed investments, but against $3.5 million. We view this denominator as an arbitrarily small amount, which resulted in a 59% ROIC and a 50% IRR.

ROIC and IRR seem absurd on other fronts. This divorce is highly complex and has already spanned over half a decade, while the defendant has made significant efforts to make assets collection-remote. BUR has to continue to finance the defendant as she tries to monetize the award judgment. Further, in light of the total invested capital, the recovery is unimpressive.

These valuation choices are especially important in light of continued adverse developments in the case. A $436 million yacht belonging to Akhmedova's ex-husband, Farkhad Akhmedov, was impounded in Dubai last year to secure the award, but it was released from the port this March after Dubai courts disallowed the seizure.[56,57] As a further negative twist, Akhmedov has filed suit in Dubai seeking $85 million in damages for the yacht's wrongful impoundment.[58] The defendants in the damages suit include not just Akhmedova, but also BUR, cementing the unclear and perhaps unfavorable nature of this case. Accordingly, it seems not only premature

[53] Burford Capital Investment Data, Case 177517a
[54] https://www.smh.com.au/business/markets/i-don-t-want-to-play-the-victim-one-of-the-costliest-divorces-in-history-is-getting-messier-20180607-p4zjyl.html
[55] Burford Capital Investment Data, Case 179649
[56] https://www.reuters.com/article/us-dubai-russia-divorce-yacht/dubai-court-restores-yacht-to-russia-tycoon-move-disputed-in-divorce-contest-idUSKCN1R91TY
[57] https://www.bbc.com/news/world-middle-east-47737292
[58] https://gulfnews.com/uae/luna-yacht-tycoon-files-85-million-damages-against-ex-wife-1.63271513

but outright irresponsible to create a Partially Concluded Investment showing a favorable IRR on a miniscule invested capital base that ignores approximately $15 million of investment and likely ongoing funding commitments, if not damages.

#5 Delaying Recognizing a Trial Loss for Two Years

In the past, BUR has delayed categorizing a loss from an adverse opinion as a Concluded Investment, thereby benefiting its return metrics. In 2010, BUR financed an international arbitration, *Progas Energy Ltd. v. Pakistan* ("Progas"). The shareholders of Progas, a defunct LNG company, claimed that the Pakistani government had intentionally ruined and expropriated the business.[59] BUR invested $10.4 million in Progas in at least two separate tranches.[60] In August 2016, the tribunal handed a loss to the plaintiffs.[61] BUR, however, failed to include this total loss in its table of Concluded cases until year-end 2018.[62] It should be noted that BUR's client appealed the loss, but BUR's 2018 disclosure admitted that "arbitration decisions are very difficult to overturn and it rarely makes sense to spend incremental capital trying to do so".[63]

#6 Keeping Trial Losses out of the "Concluded Investment" Category

BUR has a tendency to avoid recording impairments when they are near-certain or, in some cases, total losses, which results in inflated IRRs and ROICs. For example, BUR financed a number of Inter Partes Review (IPR) patent challenges by generic drug company Neptune Generics, LLC ("Neptune"). However, by October 2017, one of these had received an adverse judgement.[64] Neptune's loss was upheld on appeal.[65] Meanwhile, other IPR petitions were not even instituted in the first place.[66,67] However, Neptune remains Unconcluded, rather than Partially Concluded, contrary to what a reader might expect. The associated $7.6 million in commitments and $6.2 million in deployed capital for Neptune is unimpaired, per BUR's reporting.[68]

BUR committed $4.8 million to finance a stockholder class action suit against RCR Tomlinson ("RCR"), an Australian engineering group. The case is marked as ongoing.[69] However, after the initiation of the related class action suit, RCR Tomlinson entered bankruptcy with a significant

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59 https://www.law360.com/articles/834983/pakistan-dodges-573m-arbitration-over-gas-import-terminal
60 Burford Capital Investment Data, Case 111008
61 http://tribune.com.pk/story/1173851/court-arbitration-pakistan-wins-case-lpg-terminal-operator-london/
62 See Burford Capital 2017 Annual Report, p. 15, 2010 Vintage, and contrast with 2018 Annual Report, p. 20, 2010 Vintage.
63 BUR 2018 Annual Report, p. 33.
64 https://web.archive.org/web/20180219040124/https://litigationfinancejournal.com/burford-backed-neptune-generics-loses-patent-infringement-case-eli-lilly/
65 https://www.biospace.com/article/releases/u-s-court-of-appeals-rules-in-favor-of-lilly-in-alimta-vitamin-regimen-patent-lawsuit/
66 https://portal.unifiedpatents.com/ptab/case/IPR2016-00348
67 https://portal.unifiedpatents.com/ptab/case/IPR2016-00049
68 Burford Capital Investment Data, Case 166813
69 Burford Capital Investment Data, Case 181730

secured and unsecured debt load ahead of equity.[70] As a result, stockholders are likely to recover little to nothing from previously announced suits. BUR has not adjusted down RCR's carrying value to account for the likely restructuring.

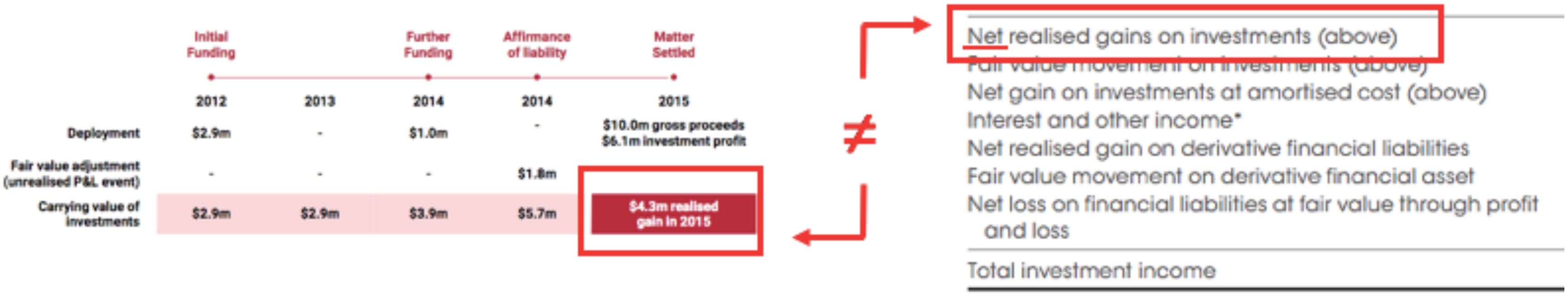
In 2015, BUR agreed to finance a portfolio of law firm Hausfeld LLP's cases. Since then, BUR has committed $44.3 million and deployed $34.4 million for these.[71] However, several negative developments have come down in the Hausfeld cases. For example, a three-judge tribunal expressed a skeptical view of the merits of a lawsuit against Volkswagen that Hausfeld filed on behalf of automobile owners, eventually denying the case in January 2019.[72] Hausfeld must now appeal that ruling at the Federal Court of Justice, Germany's highest court.[73] Furthermore, the Federal Court of Justice handed down a ruling in February 2019 denying BUR the ability to collect proceeds from a separate Hausfeld case.[74,75] BUR's marks on the Hausfeld portfolio do not incorporate any of these negative developments, despite their potentially recovery-killing implications.

#7 Failing to Deduct Various Costs against Recoveries, Including the Very Operating Expenses Associated with the Investments Themselves

As we discuss infra, BUR's reported operating expenses are approximately 9% of its adjusted capital base. In other words, approximately 9% of returns generated by the capital base we believe is available to fund returns goes to funding the business. In our view, BUR investors are effectively paying a roughly 9% fund expense ratio. We believe that return metrics excluding these expenses are misleading.

[70] https://www.afr.com/business/construction/rcr-tomlinson-creditor-claims-forecast-at-630m-investors-last-in-the-queue-20181203-h18my9
[71] Burford Capital Investment Data, Case 144379
[72] https://www.bloomberg.com/news/articles/2018-12-18/vw-seen-scoring-new-victory-in-german-test-case-by-diesel-owner
[73] https://www.reuters.com/article/us-volkswagen-emissions-court/volkswagen-customer-plans-to-take-diesel-case-to-germanys-highest-court-idUSKCN1Q8119
[74] https://litigationfinancejournal.com/german-court-rules-litigation-funder-cannot-collect-earnings-telecomm-case/
[75] https://www.whitecase.com/publications/alert/german-federal-court-justice-prohibits-third-party-funding-actions-confiscation

BUR Uses "Realized Gains" to Mislead Investors About its Fair Value Accounting



BUR also misleads investors about the egregiousness of its fair value accounting by very cleverly conflating two distinct concepts: Realized Gains and *Net* Realized Gains. BUR's total investment income generally shows a roughly 50/50 split between Net Realized Gains and Fair Value Movements. Net Realized Gains actually include previously recognized Fair Value Gains. In other words, a Net Realized Gain is the Proceeds minus BUR's invested capital in the case – not minus the investment's Carrying Value. We think the vast majority of investors believes the opposite is true – that Net Realized Gains are Proceeds minus the Carrying Values.[76] To the extent we are correct that most investors misunderstand Net Realized Gains, it is almost certainly because BUR deliberately misled them.

If one misunderstood Net Realized Gains to be Proceeds minus Carrying Values, then having a fairly consistent equal split between Net Realized Gains and Fair Value Gains would be reassuring of the prudence of BUR's fair value accounting. It would imply that period after period, BUR monetized cases for amounts significantly higher than carrying values (which include Fair Value Gains). It would therefore seem that BUR's Fair Value Gains are generally conservative relative to the real values of the claims. It would also be comforting that the Fair Value Gains in each period were roughly equal to these Net Realized Gains.

[76] Our perception is based on reading sell-side research and investor-published research pieces on BUR.

However, in the real world of BUR accounting, significant Net Realized Gains do not imply that BUR's Fair Value Gains are so conservative. Even more problematic is that when BUR books a Net Realized Gain (that includes a previously booked Fair Value Gain), to balance out the accounts, an amount equal to the previously booked Fair Value Gain is deducted from the current period's Fair Value Movements. <u>This has the effect of making the current period's Fair Value Gains look lower than they actually are</u>. BUR reported $277.3 million of investment income in H1 2019. The recent Petersen sale likely allowed BUR to book H1 2019 fair value gains in excess of $200 million – i.e., at least 72% of period investment income.

To illustrate how BUR's accounting really works, we start with the example on the below slide from the 2018 Capital Markets Day presentation.[77] BUR shows a "realised gain" of $4.3 million highlighted in the bottom right corner, which is net of its invested capital and a $1.8 million fair value gain.

	Initial Funding 2012	2013	Further Funding 2014	Affirmance of liability 2014	Matter Settled 2015
Deployment	$2.9m	-	$1.0m	-	$10.0m gross proceeds $6.1m investment profit
Fair value adjustment (unrealised P&L event)	-	-	-	$1.8m	
Carrying value of investments	$2.9m	$2.9m	$3.9m	$5.7m	$4.3m realised gain in 2015

If "realised gain" were the same thing as Net Realized Gain, then both BUR's Net Realized Gains account and Total Investment Income would increase by $4.3 million. However, in the real world of BUR accounting, Net Realized Gains actually increase by $6.1 million (which BUR refers to as "investment profit" in the above slide). To avoid double-booking the Fair Value Gain portion of $1.8 million, the $1.8 million is simultaneously subtracted from BUR's current period Fair Value Movements.

We believe that at least 72% – and possibly as much as 90% – of H1 2019 Total Investment Income was really from Fair Value Gains. Out of $277.3 million of Total Investment Income in H1 2019, BUR reported only $153.9 million of Fair Value Movements. Just before the end of the period, BUR sold another 10% of its Petersen claim for $100.0 million.[78] (Note that BUR has a pattern of monetizing Petersen shortly before period ends.)[79] The cost of this portion of the Petersen claim was $2 million.[80]

It is reasonable to assume that BUR was already carrying Petersen at least at 60% of the $1 billion value implied by the June sale of $100 million. BUR's aggressive pre-monetization Fair

[77] https://www.burfordcapital.com/wp-content/uploads/2018/11/Burford-Master-Capital-Markets-Slides_FINAL.pdf slide 46.
[78] https://www.burfordcapital.com/wp-content/uploads/2019/06/2019.06.24-Burford-Capital-Supreme-Court-denial-of-Petersen-hearing-sale-of-Petersen-interests-FINAL.pdf
[79] Includes monetizations on December 30, 2016; June 12, 2017; and June 24, 2019.
[80] The deployed costs for Petersen would be no more than $18.2m as of 12/31/2018 as per Burford Capital Investment Data

Value Gains on Napo and Desert Ridge show that the company books significant fair value gains on cases ahead of monetizations (of course Napo's "proceeds" were largely non-cash):

($millions)	**Initial Investment**	**2013**	**2014**	**2016**	**2017**
Desert Ridge					
Carrying Value	7.0	24.6	31.7	38.1	
Proceeds				38.1	
Carrying Value / Proceeds	**18%**	**65%**	**83%**	**100%**	
Napo					
Carrying Value	7.4	15.8	21.0	21.0	21.0
Proceeds					21.0
Carrying Value / Proceeds	**35%**	**75%**	**100%**	**100%**	**100%**

If Petersen had already been marked at 60% of the subsequent monetization value, then BUR would have needed to net out the $58 million Fair Value Gain against H1 2019 Fair Value Movements. In that scenario, the gross Fair Value Gains BUR booked in the period would have been $210.9 million (76.1% of total investment income).

Had BUR already marked that portion of Petersen up to $100.0 million, which we believe is not an unreasonable assumption, then the period's gross Fair Value Gains would have been $252.9 million (90.8% of total investment income).

How to confirm that Net Realized Gains include previous Fair Value Gains

IFRS allows BUR to choose whether show the realized gain portion of its investment income as either Proceeds minus Carrying Value or Proceeds minus Invested Capital (with previous Fair Value Gains netted out against current period Fair Value Movements).[81] To be fair to the International Accounting Standards Board, it might have been hard to contemplate a situation in which a fund manager could be this heavily incentivized to aggressively mark fair value gains. We know from two sets of data points that BUR's Net Realized Gains equal Proceeds minus Invested Capital.

An investor skeptical of our analysis might point to BUR's Financial Reporting and Investment Valuation page, which describes Realized Gains as Proceeds minus Carrying Value (forgetting of course that this does not describe *Net* Realized Gains):[82]

[81] "A separate disclosure of realised and unrealised gains or losses from financial instruments classified as at FVPL is not required by IFRS. However, a fund may find it useful to provide such information. Often the realised profit is the basis for the amount that must be distributed to avoid incurring a taxation liability or the amount that may be distributed in terms of the contract with shareholders. The calculation of the realised and unrealised gains or losses is often driven by jurisdictional requirements and, as such, differences are expected (e.g., some funds only include the unrealised gains or losses that have arisen during the reporting period). A fund which chooses to provide such information should disclose the basis for the calculation and explain how the split between realised and unrealised is determined." https://www.ey.com/Publication/vwLUAssets/EY-good-investment-fund-limited-equity-2018/$FILE/EY-good-investment-fund-limited-equity-2018.pdf p. 25.
[82] https://www.burfordcapital.com/investors/investor-information/financial-reporting-and-investment-valuation/

Realized gains are straightforward: they represent the amount of profit, net of the return of Burford's invested capital and any previously recognized unrealized gains, on an investment that has either resolved entirely or has been settled or adjudicated such that, in Burford's view, there is no longer litigation risk associated with the investment. (In the latter event, Burford may discount the anticipated profit in respect of an investment to

First, BUR's disclosures on Teinver makes clear that BUR booked previously recognized Fair Value Gains as part of the Net Realized Gain. BUR disclosed that its 2018 Net Recognized Gains included $87.2 million from the sale of its Teinver claim.[83,84] The sale proceeds were $100 million (the $7 million received for the put option would not be deemed sale proceeds).[85] At the time of the sale, BUR's Carrying Value for Teinver was $69 million.[86] That Carrying Value included a Fair Value Gain of approximately $56.2 million, given that BUR's invested capital was $12.8 million.[87]

Clearly, the Net Realized Gains amount of $87.2 million was the profit above its invested capital, and not above the Carrying Value. Therefore, it is clear that Net Realized Gains are Proceeds minus Invested Capital.

The second way to know that Net Realized Gains are Proceeds minus Invested Capital is by comparing the cumulative Fair Value Movements since BUR's inception to the value of Fair Value Gains (a/k/a Unrealized Gains) on its balance sheet. If BUR's accounting for Net Realized Gains matched the description BUR gives of how Realized Gains work (i.e., Proceeds minus Carrying Values), then the cumulative value of Fair Value Movements would greatly exceed the Fair Value Gains currently on BUR's balance sheet. The reason this would be the case is that there would be no amount subtracted from each period's Fair Value Movements to balance out previously booked Fair Value Gains that were included in Net Realized Gains. In other words, if Net Realized Gains contained no Fair Value Gains, then there would be no offset to the current period's Fair Value Movements. In that way, cumulative Fair Value Gains from the income statement accounts would grow significantly larger than Fair Value Gains on the balance sheet.

However, BUR's cumulative Fair Value Movements roughly equal the Fair Value Gains on its balance sheet. We calculate BUR's cumulative Fair Value Movements through December 31, 2018 to be $591.0 million. BUR discloses that as of December 31, 2018, the Fair Value Gains as a percentage of its $1.6 billion of its Investments is 39%, which is roughly $621.0 million.[88] (We believe the approximately 5% delta between the two is due to FX and other changes to investments).

[83] BUR 2018 Annual Report, p. 85.
[84] The claim sold is obviously Teinver because of the reference to the put option with a $7 million fair value.
[85] https://www.burfordcapital.com/newsroom/burford-sells-teinver-investment-107-million-736-return/
[86] https://www.burfordcapital.com/newsroom/burford-capital-announces-successful-conclusion-to-teinver-annulment-applications/
[87] https://www.burfordcapital.com/newsroom/burford-sells-teinver-investment-107-million-736-return/
[88] BUR 2018 Annual Report, p. 30.

Even the following short assessment shows that BUR's Fair Value Gains appear highly questionable, and grew rapidly in H1 2019. BUR discloses balance sheet investments devoted to "core litigation finance" investments, or portfolio and single-case financings. At year-end 2018 and at the end of H1 2019, such totals stood at $1.2 billion and $1.4 billion, respectively. However, corresponding cash costs were a mere $645 million and $654 million in the same respective periods. This means that BUR marked up its core balance sheet investments a whopping 90% in 2018, with markups growing further to an eye-popping 135% in H1 2019. It stretches credulity to imagine such marks are conservative:

Burford Capital Balance Sheet Core Litigation Fair Value Markups

($million)	**FY2018**	**1H 2019**	**Sources**
Total Balance Sheet Investments	1,592	1,768	*2018 AR, p. 66; 2019 Interim Report, p. 20*
Core Litigation Investments, % of Total	77%	87%	*2018 AR, p. 24; H1 2019 Presentation, p. 9*
Carrying Values…	1,227	1,539	
…Vs. Cash Cost	645	654	*2018 AR, p. 20; 2019 Interim Report, p. 9*
Fair Value Markup of Carrying Values	**90%**	**135%**	

Why does BUR discuss Realized Gains in its materials and filings when it does not accurately describe BUR's accounting for Net Realized Gains?

Our best guess is because they're lawyers and they like making tens of millions of dollars through selling stock.

We call upon BUR to detail its historical gross fair value gains by period.

Similarly, in the Petersen case, BUR books partial recoveries of $236.0 million against proportional costs of $7.0 million.[89] This numerical exercise generates a staggering ROIC of 2,553% and IRR of 308%. Yet, despite the undisputed success of this case, BUR has pulled forward a tremendous amount of returns without accounting for a raft of accompanying obligations.

Burford must fund the entirety of the Petersen litigation as a condition of the ~$18 million indemnification rights purchase that allows it to access 70% share of Petersen proceeds.[90] BUR issued a press release in January 2017 in conjunction with its stake sale. In this communication, BUR stated that it expected "meaningful expenses" in the Petersen case to push its recoveries below 60% of the overall entitlement, rather than the headline 70%.[91] Such costs likely include contingency fees from the litigating law firms. As we noted above, BUR's litigation liabilities are nowhere to be found amid the returns data showing hundreds of millions of dollars in net recoveries from stake sales.

Nevertheless, BUR remains on the hook for significant expense that is not reflected in Petersen ROICs and IRRs. At the barest minimum, BUR should report the invested capital base for Petersen inclusive of the ~$18 million purchase price and the ~$6.9 million in associated investment banking and brokerage fees to make the secondary sales.[92,93] Adding a conservative $20 million in estimated cash legal fees incurred to date for this complex international litigation yields an ROIC that, while still impressive, is over seven times smaller than the 3,278% that Burford claims.[94]

Petersen ROIC Inclusive of Costs

($millions)	
Initial Indemnification Rights Purchase (Required to Receive Proceeds)	18.0
Investment Banking and Brokerage Fees	6.9
Cash Legal Fees	20.0
Proportional Petersen Costs	**44.9**
Recoveries as of H1 2019	236.0
ROIC	**426%**

Contingency fees and other legal expenses are a significant and unaccounted boat anchor on BUR's recoveries, and we assume they will bring BUR's initial 70% portion of the Petersen claim to ~50%. As a result, BUR's 1H 2019 sale of 10% of its entitlement for $100 million values the Petersen claim at $2 billion, not the $1.4 billion the headline figures would appear to imply.[95]

89 Burford Capital Investment Data, Case 143539
90 https://www.leagle.com/decision/infdco20161027963
91 https://otp.investis.com/clients/uk/burford_capital/rns/regulatory-story.aspx?cid=1377&newsid=832332
92 Burford Capital 2018 Annual Report, p. 89
93 Burford Capital 2019 Interim Report, p. 2
94 Burford Capital Investment Data, Case 143539
95 https://www.burfordcapital.com/newsroom/us-supreme-court-denies-petersen-hearing-further-burford-sale-of-petersen-interests/

Appearance Versus Reality: Burford's 1H 2019 Petersen Stake Sale	
Sale Price	$100 million
% of Original Entitlement Sold	10%
BUR's Stated Claim Value	$1.0 billion
BUR Entitlement Headline % of Petersen Proceeds	70%
Implied Petersen Claim Value	$1.4 billion
BUR Entitlement Effective Portion of Petersen Claim	**50%**
Implied Petersen Claim Value	**$2.0 billion**

At the most recent sale price, the Petersen claim's valuation approaches even optimistic estimates of an eventual award amount. BUR, however, stands to realize only approximately $600 million after deducting expenses:

Burford's Net Proceeds From a Petersen Award at the Most Recent Sale Price	
Award	$2.0 billion
Gross Proceeds of the BUR Entitlement	$1.4 billion
BUR Entitlement Proceeds Net of Legal Fees and Costs	$1.0 billion
BUR's Remaining % of the Original Entitlement	61.25%
BUR's Net Proceeds	**$612.5 million**

Moreover, BUR has a habit of trading claims around period ends. On December 30, 2016, for example, BUR sold a very small portion of the Petersen claim.[96] This act, consummated the day before year-end, allowed Burford to take significant fair value markups on the asset. Similarly, BUR reported Petersen sales less than three weeks before the end of the half-year 2017 period[97] and under a week before the conclusion of H1 2019.[98] In a vacuum, such selling behavior would be innocuous. However, viewed in the context of BUR's other misleading behavior, this pattern suggests a means by which the company boosts reported income.

Given the several ways in which BUR deceives regarding the Petersen specifics, we would not be surprised to see that the company has, in fact, marked Petersen close to its current sale value. Taking Burford's balance sheet capital at cost, we see that even assuming a generous markup of the portfolio in each period since 2016, Petersen is likely marked very close to its latest sale value. First, we compute BUR's balance sheet capital at cost:[99]

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96 https://www.burfordcapital.com/newsroom/burford-reports-secondary-market-transaction-activity/
97 https://www.burfordcapital.com/newsroom/burford-reports-secondary-market-activity-press-release/
98 https://www.burfordcapital.com/newsroom/us-supreme-court-denies-petersen-hearing-further-burford-sale-of-petersen-interests/
99 See infra for calculation of the percentage of the H1 2019 investment balance at fair value versus at cost

Burford Balance Sheet Capital at Cost

($millions)	**2016**	**2017**	**2018**	**H1 2019**
Fair Value of Investments	559.7	1,075.9	1,592.4	1,768.4
% of Book Marked Up	31%	36%	39%	44%
% of Book at Cost	69%	64%	61%	56%
Value of Book at Cost	386.2	688.6	971.4	994.1
Less Third-Party Investments	*0.0*	*93.8*	*112.1*	*202.2*
Balance Sheet Capital at Cost	**386.2**	**594.8**	**859.2**	**791.9**

Source: Burford Capital Annual and Interim Reports

Then, we assume annualized 25% markups across the balance sheet, excluding the Teinver investment, which was obviously marked up at a faster rate. Even under these conditions, the Petersen claim's fair value today sits at 89% of its most recent implied net proceeds. If Petersen is marked in this way, which does not stretch the imagination, then BUR has already pulled the vast majority of income from a favorable resolution at current market prices.

BUR Has Been Highly Reliant on Only Four Cases for its Monetizations, Showing that the Broader Portfolio Has Lacked Strength

Through manipulating ROICs and IRRs, BUR presents an image of a business that derives profits from a broad range of cases in its book. The reality is that BUR is much more concentrated, and has really been dependent on just four cases (including bailed-out Napo) to generate 66% of its net realized gains over the prior seven and a half years. We calculate that without these four cases, BUR's concluded cases generated a ROIC of only 16% since 2012.

Below, we calculate the contributions of four cases—Teinver, Jaguar, Desert Ridge, and Petersen—to net realized gains. We arrive at what we believe is a reasonably accurate picture, given BUR's disclosures. In each of the past three years, these cases have comprised 70% or more of net realized gains. Notably, one, Napo, is highly suspect and another, Desert Ridge, retains a significant contingent liability. These facts and computations suggest to us that Burford has little breadth to show for the 1,110 litigation claims underlying the investment portfolio.[100]

Four Cases Contribute the Majority of Net Realized Gains

($millions)	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**H1 2019**	**Total**
Jaguar Net Realized Gain	0.0	8.2	5.7	0.0	0.0	0.5	0.0	0.0	14.4
Desert Ridge Net Realized Gain	17.6	10.8	0.0	0.0	2.7	0.0	0.0	0.0	31.1
Teinver Net Realized Gain	0.0	0.0	0.0	0.0	0.0	0.0	87.0	7.0	94.0
Petersen Net Realized Gain	0.0	0.0	0.0	0.0	4.0	97.5	29.3	98.2	229.0
Total Net Realized Gain From Four Cases	**17.6**	**19.0**	**5.7**	**0.0**	**6.7**	**98.0**	**116.3**	**105.2**	**368.5**
Total Net Realized Gain in Period	11.7	8.0	12.0	60.3	47.4	122.7	171.5	139.5	573.1
Net Realized Gain Attributable to Burford	11.7	8.0	12.0	60.3	47.4	135.7	155.1	124.7	554.8
Percentage of Total Net Realized Gains	**150%**	**238%**	**48%**	**0%**	**14%**	**72%**	**75%**	**84%**	**66%**

Sources: Burford Capital Annual and Interim Reports, Press Releases, and Investment Data

100 https://www.burfordcapital.com/wp-content/uploads/2019/04/BUR-31172-Annual-Report-2018-Web.pdf

Without these cases, BUR's vaunted recoveries no longer look as pretty. Using the same net realized gains computations as above, BUR's sky-high ROICs fall back to 19% over that same seven-and-a-half-year period:

When Excluding Four Cases, Burford's Balance Sheet ROIC Falls to 19%

($millions)	2012	2013	2014	2015	2016	2017	2018	H1 2019	Total
Realizations	25.9	37.5	55.9	139.2	177.6	313.5	518.4	301.9	1,569.9
Net Realized Gains	11.8	6.5	12.0	60.4	47.5	135.7	155.1	124.8	553.6
Invested Capital	14.1	31.0	44.0	78.8	130.2	177.8	363.3	177.2	1,016.3
ROIC	**84%**	**21%**	**27%**	**77%**	**36%**	**76%**	**43%**	**70%**	**54%**
Net Realized Gains Excluding the Four Cases	(5.8)	(12.5)	6.3	60.4	40.8	37.7	38.8	19.6	**185.1**
Invested Capital Excluding the Four Cases	10.1	24.3	41.0	78.8	129.5	165.9	349.6	175.4	**974.8**
ROIC Excluding the Four Cases	**(58%)**	**(51%)**	**15%**	**77%**	**31%**	**23%**	**11%**	**11%**	**19%**

Sources: Burford Capital Annual and Interim Reports

However, even this ROIC calculation gives BUR too much credit for the poor cash returns on the body of its investments. In H1 2019, BUR realized an investment in its complex strategies fund, whose assets it books entirely as its own while having only contributed 30% of the total capital.[101] Accordingly, there are approximately $18.8 million of gains in H1 2019 that should not belong to a calculation of Burford's returns on its own capital:

H1 2019 Complex Strategies Investment Effect on Returns

($millions)	
Balance Sheet Profit	8.0
Burford Balance Sheet as % of Complex Strategies Fund	30%
Third-Party Profit (Negative Adjustment to Net Realized Gains)	**18.7**
Total Investment	48.0
Third-Party Capital (Negative Adjustment to Invested Capital)	**33.6**

In addition to this case, there appear to be four realizations that have taken place in H1 2019 as merely settlements, or non-cash realizations.[102] Napo demonstrates that BUR has booked illusory non-cash realizations before. We believe we have identified two of these investments.[103,104] Excluding these investments to arrive at a truer, cash ROIC further depresses BUR's H1 2019 returns number:

[101] BUR 2019 Interim Report, p. 7
[102] BUR 2019 Interim Report, p. 8
[103] Burford Capital Investment Data, Case 178822
[104] Burford Capital Investment Data, Case 181486

H1 2019 Non-Cash Settlements Effect on Returns

($millions)

Case 178822	
Balance Sheet Profit (Negative Adjustment to Net Realized Gains)	7.4
Balance Sheet Capital (Negative Adjustment to Invested Capital)	7.5
Case 181486	
Balance Sheet Profit (Negative Adjustment to Net Realized Gains)	7.2
Balance Sheet Capital (Negative Adjustment to Invested Capital)	4.2

After deconsolidating what isn't BUR's, unbooking their non-cash realizations, and undoing the reliance on a select four cases, BUR H1 2019 cash ROICs actually **turn negative**. Under these conditions, ROIC since 2012 also drops to 16%.

When Excluding Four Cases, Off-Balance-Sheet Returns, and Non-Cash Settlements, Burford's ROIC Falls to 16%

($millions)	2012	2013	2014	2015	2016	2017	2018	H1 2019	Total
Net Realized Gains	(5.8)	(12.5)	6.3	60.4	40.8	37.7	38.8	(13.7)	**151.8**
Invested Capital	10.1	24.3	41.0	78.8	124.0	165.9	349.6	163.7	**957.6**
ROIC	**(58%)**	**(51%)**	**15%**	**77%**	**33%**	**23%**	**11%**	**(8%)**	**16%**

Sources: Burford Capital Annual and Interim Reports

We Believe BUR is at High Risk of Financial Stress

BUR's operating expenses, financing costs, debt, and funding commitments, in our view, put it at high risk of a liquidity crunch. BUR is already arguably insolvent. There are two components to this analysis: the size of BUR's "real" invested capital and BUR's non-investment costs.

We see the amount of capital BUR has to fund its litigation investments, operating costs, and financing costs as being $880.3 million. Below are our adjustments to arrive at $880.3 million:

1. Start with H1 2019 Investments of $1,768.4 million.[105]

2. Subtract third party interests of $202.2 million.[106] The balance is $1,566.3 million.

3. Reduce by the amount of Fair Value Gains, which is 43.8% of the total.[107] (Fair Value Gains are not available to fund expenses and invest in other cases.) The result is $686.0 million.

4. The result is $880.3 million.

[105] BUR H1 2019 Interim Report, p. 33.
[106] BUR H1 2019 Interim Report, p. 33.
[107] We derive 43.8% by adding H1 2019 Fair Value Movements of $152.9 million to the Fair Value Gains balance of $621 million (39% of $1.6 billion).

We believe BUR is at high risk of having a liquidity crunch. We consider the $880.3 million to be the capital base that must generate returns to fund BUR's operating expenses, financing costs, and ongoing investments.

- Operating costs – BUR reports that on a LTM basis, the operating cost associated with its balance sheet investing is $74 million.[108] We think it is reasonable to adjust operating costs up to $84 million because we suspect BUR over-allocates expenses to its fund management business. BUR discloses that the LTM operating expense for GKC is $15 million. Given that substantially all research resources and employees should be at Burford itself (rather than at GKC), we struggle to understand how GKC incurs expenses beyond those of administering a fund. We believe it is generous to adjust GKC's operating expenses to $5 million, and doing so implies BUR balance sheet business operating expenses that are higher than those disclosed by $10 million.

  Based on BUR's disclosures, its LTM operating expenses are 8.4% of the $880.3 million adjusted capital base. Re-allocating GKC expenses as we do above increases the burden to 9.5%. Therefore, the way we view it, the first roughly 9% of realized returns BUR generates are used for funding the business. In our view, these number should be thought of as fund expense ratios. Even the 8.4% is a staggering expense ratio for a fund. These percentages indicate to us that BUR management has little talent for cost control and / or litigation finance is not a very attractive business.

  BUR's total staff costs (including at GKC) were $63 million on an LTM basis. At 110 employees, that works out to $570,000 per employee. Because BUR is a Gurnsey company, it is not required to disclose its executive compensation. It is also possible that insiders are paying themselves quite handsomely in cash.

- Financing costs – BUR's LTM interest expense was $39 million, which is 4.4% of the adjusted capital base. BUR's LTM dividends were $27 million, which is 3.1% of the adjusted capital base. In other words, financing costs were 7.5% of the adjusted capital base on a LTM basis.

BUR is arguably insolvent. If subtracting BUR's funded debt balance of $637.8 million from the adjusted capital base, there is only a $243.1 million cushion.[109] However, BUR has future balance sheet litigation commitments of $708.2 million.[110] Historically, approximately 85% of these commitments are eventually deployed, implying that BUR has an off balance sheet liability of $602.0 million. When looking at BUR's solvency through this methodology, BUR has negative equity of -$358.9 million relative to the adjusted capital base.

[108] $89 million overall operating expenses, minus $15 million GKC expenses.
[109] As of H1 2019.
[110] Burford Capital H1 2019 Interim Report, p. 46.