

Burford Capital: Leader in Nascent Litigation Financing Asset Class

Artem Fokin of Caro-Kann Capital presented his in-depth investment thesis on Burford Capital (UK: BUR) at Best Ideas 2019.

Read Artem's [preview](#).

The following transcript has been edited for space and clarity.

Caro-Kann Capital is named after the opening in chess, e2 e4 c7 c6. We invest in special situations and compounders. I generally look for securities that are mispriced due to lack of sell-side coverage and awareness among buy-side peers. I typically focus on companies with a market cap of up to \$2 billion, but there can be exceptions. My favorite investment patterns for special situations include spin-offs, a high-growth business segment hidden by a larger struggling segment, and sum-of-the-parts stories. My favorite business models for compounding machines are platform businesses with network effect and flywheel business models. We generally run a long bias fund, typically 80% to 100% net long.

Allow me to start this presentation by bringing up Stephen Schwarzman, who co-founded Blackstone with his partner and former boss in 1985. Blackstone's current market cap is about \$35 billion, and this is arguably the most successful private equity firm of all time. Imagine we had a time machine and went back to 1995, exactly 10 years after Blackstone launched its operations. We met 48-year-old Stephen Schwarzman, and he offered us to buy shares of a privately held Blackstone at roughly 15x last 12 months earnings. To be clear, I am talking here about investing in the management company, not in a PE firm. We can't do the exact math because it was private back then, but there are enough informational tidbits to estimate that our return would be roughly 20x.

This presentation is not about Blackstone, but it still deals with a great investment opportunity. Led by two extraordinary founders, this company is called Burford Capital and is destined to dominate the litigation finance and legal claims investment industry in the same way Blackstone has dominated the global PE industry. The reason I picked 1995 as the destination for our time travel is that Burford launched its operations 10 years ago, in early 2009. I think it can compound its intrinsic value at 25% annually for many years to come.

Let's start with the elevator pitch. Burford is a compounding machine, and the investment opportunity, in my opinion, can be best described as "growth at UNreasonably cheap price." Burford is the leading and largest litigation finance provider in the world. It funds litigation and international arbitration claims by paying legal fees, and its average check size these days is somewhere around \$20 million. In exchange, it gets for a share of the litigation award. Burford invests in legal claims from its own balance sheet and has capital of exactly \$1.6 billion. It also manages hedge funds with external outside capital and charges a management fee of between 0% and 2%, as well as performance fees of between 20% and 42%. The company recently announced it would manage \$667 million for a sovereign fund with a 42% incentive fee. Its AUM attributable to third parties are roughly \$2.3 billion.

Burford offers a highly compelling customer value proposition. First, it is at the cutting edge of transforming the legal industry. Law firms now face growing resistance from clients reluctant to pay the extremely high legal fees. Burford's customer value proposition is compelling because it allows the corporate clients to achieve several goals: better monetize their litigation assets, avoid unfavorable accounting treatment prescribed by either GAAP or IFRS, and make their in-house legal departments profit centers as opposed to cost centers. What general counsel of a big US or international company

would not want to become a profit center after being viewed as a cost center for years? Importantly, law firms operating as a classic equity partnership are not well positioned to take large cases on a contingency basis. As a former practicing lawyer at a big New York firm, I can fully appreciate the challenges.

Burford has an extraordinary track record. It has generated 31% internal rate of returns on its capital over 10 years. These superb investment returns and earnings reinvestment have allowed the company to grow its earnings at a pace of about 50%. Burford's return on equity has been about 30%. When someone sees such returns, they are likely to start immediately wondering about incoming competition. I think Burford's returns are well protected by high barriers to entry. First, no sizeable player has entered the space since 2015, which shows it's not that easy to do it. Number two, compared to existing players, Burford benefits from its scale, reputation, experience, and proprietary data, all of which allow it to run a better and superior underwriting process for its investments.

The legal industry is huge, and the penetration of litigation finance is not higher than 1% or 2%. Low penetration, compelling customer value proposition, and Burford's undisputed industry leadership create, in my opinion, an extremely long growth runway, potentially lasting for decades. Importantly, we don't need to wait for decades to see returns on our investment. Burford offers a compelling valuation today, trading at about 15.5x last 12 months earnings. I expect earnings to be going substantially higher over the next several years because the incentive fees which Burford is entitled to charge are not showing up on the balance sheet or income statement right now. In addition, the company can reinvest its own capital at very high IRR.

Management is well aligned with public shareholders. Each of the two co-founders owns more than 5%, or over \$200 million worth of shares each. The next 20 executives collectively hold roughly \$80 million worth of stock. Here is something remarkable: every single employee is a shareholder! This point, in my opinion, speaks volumes. Very few companies in the history of corporate America or the corporate world make every employee a shareholder, and those who do generally create tremendous shareholder value. Think how powerful it is when every single employee shows up at the office, and they know that they have a vested interest in this company succeeding beyond their selfish motivations. They want everybody to succeed, which creates totally different dynamics.

The leadership team has a long-term vision, and this is mostly due to aligned incentives. Interestingly, management refuses to give guidance despite most people asking them to do so. Their communication style is very candid and straight to the point. Their annual reports are wonderful documents, and whenever I read them, I have a genuine feeling that the management wrote those reports with a very strong desire to help people understand their business. They're not fulfilling some compliance obligation or legal duty - they want us to appreciate and understand what they do.

Importantly, Burford is not a cyclical business. It doesn't depend on the state of the economy or GDP. Companies litigate in good economies and in bad economies. I have a suspicion that litigation finance would actually go up, not down, in a recessionary environment because the number of disputes would probably go up, but companies would be even less willing to pay high legal fees. I see between 150% and 300% upside within the next three to four years.

Let's explore these elements in detail. Speaking of Burford's capital structure, the market cap is at \$4.2 billion. The company has roughly \$530 million of cash on its balance sheet. It also has debt, which is all publicly traded bonds. One quick note: Burford is listed on AIM, and its shares are quoted in British pounds, but all the financial reporting is done in US dollars.

Why does this opportunity exist? I see several reasons, one being that Burford is an AIM-listed company, and many people don't follow AIM stocks. There's low investor awareness mostly because of

this, and there is also the fact that the industry where Burford operates is fairly new. Thirdly, there are misconceptions about litigation finance. When I talked to my buy-side friends after we built the position, I had a number of those immediate reactions and misconceptions about the industry.

The most popular misconception is that if you invest in Burford, you need to have a view on the litigation outcomes of the cases Burford is investing in. Probably no buy-side investor or sell-side analyst can develop these views. Those cases take teams of very expensive, highly qualified and experienced lawyers. There is a plaintiff, and there is a defendant, and one party loses unless they settle. Even those expensive and experienced lawyers get it wrong sometimes. This obviously would make Burford uninvestable for many investors. Here's how we see things: by investing in Burford, you don't make your own judgment about litigation outcomes but let management have their view on those litigation outcomes. They will inevitably make mistakes, as everybody does, but their track record is truly outstanding. You are betting that Burford's investment process is repeatable and its prior returns have not been driven by pure luck. Burford has 10 years of returns, which I consider significant evidence that its investment is indeed repeatable and not luck. I've also heard concerns about personal injury and class actions, where litigation finance is very risky from a regulatory perspective. The good news is that Burford has nothing to do with personal injury lawsuits and class actions – it works only with corporate clients.

I want to introduce the concept that legal claims is a new and growing asset class, which is fairly counterintuitive. First of all, what exactly is litigation finance? It involves two parties. There is a litigation funder such as Burford and there is a claimant whose rights have been violated. A claimant either lacks money or doesn't want to spend their own financial resources, and therefore asks a litigation funder to provide financing. In exchange, a claimant will share some of the litigation recoveries. The most conceptually accurate approach is to consider a litigation finance provider as an investor in the asset class of legal claims. Quite frankly, I don't like the term litigation finance. What I prefer is legal claims investing. However, legal litigation finance as a term seems to be more widely accepted, so I will use both interchangeably.

Why is it so difficult conceptually to think of legal claims as an asset class? There are a few reasons, in my opinion. First, if you look at traditional investments, they would show up on your balance sheets, but legal claims never show up on the balance sheet of a party whose rights have been violated. Number two, the value of legal claims is extremely difficult to ascertain. Number three, if you lose in court, the value of legal claims ends up being zero.

Let's reverse the question. Why can legal claims be an asset class? First, legal claims have payoffs, and those range from zero (if a party loses a case) to 100% if the plaintiff wins. Second, we can attach probabilities to various outcomes of litigation, and broadly speaking, there are only four: lost at trial, settled before trial, partial victory in court, and full victory in court. Third, if we combine those two points – payoffs plus probabilities – we can calculate the expected value of a legal claim. All other asset classes have expected values as well. Think about stock investing: when we invest in stocks, we construct various scenarios and payoffs, and we estimate the probabilities of those scenarios occurring, then we calculate expected value. Final point, buying an asset substantially below its expected value is what any investing is about, and investing in legal claims is no different. The spirit of investing in legal claims is identical to the spirit of investing in any other asset class, so I have a strong belief that legal claims constitute a new and rapidly growing asset class. Burford is an investor in this new asset class. Today, the legal investing industry is in the same place where private equity was in the early 1990s.

Allow me to read an excerpt from a Burford annual report which conveys the message: "A litigation claim is an asset. It sounds slightly strange to say that as litigation claim does not comport with our traditional concept of assets, but an asset it is nonetheless. Litigation claims can be bought, sold,

hypothecated, securitized and otherwise treated like any other intangible asset. This is a crucial point as Burford's business is not the funding of legal fees to bring a claim, as though we were a class or group action lawyer operating on a contingent or conditional fee arrangement. Rather, it is the financing of an asset. Sometimes, that financing takes the form of providing capital in support of the legal fees needed to develop the asset. That's what we now call basic litigation funding. However, even that type of transaction is still asset financing; Burford's capital is provided pursuant to a financing arrangement, often accompanied by a perfected security interest in the litigation claim asset. We are not equity partners with our clients but much more like mezzanine capital providers. We provide fixed-dollar investment arrangements, no open-ended commitments."

Let's consider the total addressable market (TAM) for litigation finance. It's quite difficult to calculate its value exactly, which is due to a variety of factors. First, law firms are generally private. Many matters are confidential. While court decisions are public, their quanta are generally not aggregated. Many matters presented in front of arbitration panels are confidential. I will use two proxies for total addressable market. Proxy number one is legal fees. Nobody really knows what legal fees globally are. When you check out different expert and industry publications, they put those annually somewhere between \$600 billion and \$800 billion. Legal fees in the US alone are \$400 billion. There are more than 40,000 law firms in the US, and 15 of them generate annual revenues in excess of \$1 billion. These are massive businesses. The top 200 US law firms generate together roughly \$100 billion in legal fees.

Not all of this \$600 billion to \$800 billion is related to litigation. When I browse the websites of several large US law firms, it's my observation that approximately 20% of lawyers are litigators. This number is inherently imprecise because I didn't browse 500 law firms, just half a dozen or maybe a dozen. It's just my best guesstimate. If we assume that lawyers across practice group and departments bill the same number of hours at the same rate, which is roughly true for lawyers of the same seniority, then the litigation legal fees would account for \$120 billion to \$160 billion, which is still a massive number.

The other proxy is the quantum of litigation and arbitration awards. The exact number is unknown, but people think about it as a percent of GDP, which already speaks volumes about it. There is an arbitration institution in Paris called ICC, and it alone has a pending case load of \$200 billion. In other words, parties in Paris are disputing matters potentially worth up to \$200 billion. This is just one arbitration institution, and this estimate also completely ignores courts, which are different from arbitration panels.

One important point I didn't realize at first but appreciated through my interview with lawyers is that litigation finance is very likely to expand and increase the total addressable market. Looking at the current TAM can be a mistake because there are many cases today that parties do not bring to court for it's too expensive regardless of how strong the merits are. Burford is creating more of a level playing field for corporate America and the rest of the world. Thanks to it, even a small company can take on a Fortune 500 enterprise if the latter violated its rights. To put it another way, Burford helps David to fight Goliath.

Another important point is that litigation finance has very low penetration. The world's top 10 industry players have been investing roughly \$2 billion annually over the last few years. Thus, if we use this number against the litigation legal fees, the penetration rate is less than 2%. It is mostly low due to the novelty of the industry. In its current shape and form, it has existed for about 10 years. The law firm industry, on the other hand, is ripe for change. Law firms have very simple capital structures, and they don't have access to capital. It's partially due to laws and regulations and partially to law firm business models and the lack of tangible assets. Clients are increasingly resistant to high legal fees, which puts disruptive pressures on the legal industry and profession. The litigation finance industry is bringing solutions. We see all three components of a long growth runway: a massive total addressable

market, very low penetration, and a compelling customer value proposition.

Let's explore the customer value proposition and why clients want to work with Burford. Which pain points exactly does the company solve for its clients? Normally, when you say litigation finance, you think of a personal injury or car collision which involves an economically disadvantaged party that may not be able to pursue a legal claim to protect its rights. However, Burford doesn't work for those. It invests in legal claims arising out of disputes between what I call "big boys" - one multi-billion corporation suing another multi-billion corporation or an investor filing an arbitration claim under an international investor treaty because a sovereign state violated investor rights. It can be Venezuela, Argentina, or another one. Those don't strike me as parties that don't have money, so why would they need Burford?

First, financial standards create an unfavorable and asymmetric treatment of legal claims and legal expenses. Any legal claims a company incurs are run through P&L right away. It's an expense. Second, the company does not record any value on its balance sheet for those expenses even though it's moving toward potentially winning a litigation case. Third, even if the company eventually wins, investors will treat it as a one-off extraordinary income. As investors, we view legal expenses as normal and ongoing, but we view litigation awards as extraordinary when we analyze publicly traded companies. This creates a massive asymmetry. Thus, a public company paying substantial litigation expenses out of pocket may hurt its share price. Using litigation finance solves this problem.

Companies also have an opportunity cost of pursuing litigation. Even if a company has financial resources, it can spend its money better. There's a great story of a publicly traded company called Rurelec, which is an operator and developer of power generation capacity. It does lots of business internationally. Generally, Burford cannot talk about its client cases, but sometimes clients make information public for one reason or another. This case is one of those rare occurrences, and we benefit from their disclosure.

This is how Burford describes it: "Rurelec was pursuing an arbitration claim against Bolivia for the expropriation of one of Rurelec's power plants. Rurelec did not need capital to pay lawyers - what is generally called "litigation funding." Rather, it needed capital to continue to grow its own business, but lenders wanted very high interest rates because of the loss of its Bolivian assets." It's a Catch 22 if you think about it. "Unlike a traditional lender, Burford was able to evaluate the value of Rurelec's pending arbitration claim, and thus was able to provide the following facility: 1) a fully recourse, secured \$15 million senior loan at 12%, and 2) a contingent value right to receive a portion of the ultimate arbitration award, expressed on a sliding scale based on time and amount." Rurelec eventually won the case against Bolivia. Burford put \$15 million and generated \$11 million of net profit. It had a 73% return and 34% IRR, which are great returns.

In my opinion, how to finance the pursuit of a litigation claim is a decision no different from any capital allocation decision. If a company buys PP&E, it would consider all options: pay with cash, pay with debt, lease, and other options. Litigation should be no different. The corporate world is embracing that. If Burford is involved in a case, it generally does not disclose it, but sometimes it does, which sends a powerful signal to the other party. This is how Burford puts it: "We believe that the disclosed presence of Burford in a case should make a defendant think twice about its position as it would then know that a dispassionate, highly skilled, profit-motivated entity had evaluated the plaintiff's case and concluded that it had real merit."

Also, there are structurally constrained claimants that don't have other options. Think about investment fund managers who bought into a company which turned out to be fraudulent. A hedge fund or an investment fund suing it would not want to hit their limited partners with litigation expenses. Another example would be bankruptcy or liquidation trustee. I spoke with liquidation

trustees, and they confirm that litigation finance is a hugely attractive option for them.

Law firm economics also encourage the use of litigation finance because these companies are structured as equity partnerships. Even if a more entrepreneurial law firm is willing to take a litigation case on a contingency, it will have two challenges, at the very least. Number one, it creates a working capital deficit. Number two, US tax treatment of litigation provides that law firms which advance client expenses are not permitted to deduct those expenses, and they must therefore fund them with after-tax dollars. This is obviously a very bad outcome for law firms.

Burford uses a wide range of deal structures in investing, the typical one being “capital back + preferred return + share of the award.” Here’s an example of how that works. Let’s say Burford has provided \$10 million to a client that used those funds to pay for legal services. Burford and the client have agreed that if the client wins the case, Burford receives \$10 million back plus a 12% return per year for the duration of the legal proceedings. Thus, Burford will get \$10 million back plus \$2.4 million. This is the capital back plus preferred return. However, Burford would then receive the portion of the remaining award. Based on my numbers, it would be entitled to 25% or another \$4.4 million, so it would collect \$16.8 million on its cost basis of \$10 million.

I also want to address the issue of control. Burford does not control the litigation. It provides the money, but the decisions are made by the client, which is essential from a legal ethics perspective.

In terms of unit economics, the two most important metrics for any investment is return on capital and IRR. If, for example, Burford puts \$10 million and receives its investment back plus \$7.5 million of profit two years later, ROIC will be 75% and IRR will be roughly 32%. Burford has generated 60% ROIC and high 20% IRRs over several years, which I find amazing. These returns are calculated after losses, meaning that if the portfolio generates 75% ROIC after losses, winning cases generate 90% to 100% in order to make up for some cases Burford loses.

I’d also like to touch on the tension between ROIC and IRR. That tension is due to settled versus adjudicated cases. Think about it this way – if you go all the way to trial and the litigation lasts longer, you’d receive more money but slower, so it hurts your IRR. If you go and settle, you get less money, but your IRR is very high. A couple of years ago, Burford disclosed that it had never lost money on a settled case. According to data provided after the first half of 2018, its total portfolio has historical ROIC of 99% and IRR of 33%. However, on adjudicated cases, meaning cases that went to trial, ROIC was double the portfolio average and 27% IRR. Cases that settled fairly quickly, generally within a year, generated return on capital of 53% (half the portfolio average and 4x less than adjudicated cases) and IRR of 52%. That IRR is almost twice as large as the adjudicated cases IRR.

Burford prefers return on capital over IRR, which is consistent with corporate finance theory giving preference to NPV versus IRR, but everybody can pick their favorite metric. Asset duration is another important metric. In general, it dropped from roughly two years historically to 1.5 years in 2017. The average size of commitment increased 8x over five years, rising from \$3 million in 2013 to more than \$20 million.

If Burford is an investor in legal claims as an asset class (which it is, in my opinion), there is the issue of portfolio construction. Every investor will appreciate how important it is to have a diversified portfolio. This is what Burford said about it as early as 2011: “We have always maintained that the right way to invest in litigation risk is through a broadly diversified portfolio, and we have practiced that view assiduously. The Burford portfolio is diversified across a number of metrics, each of which is monitored by the board for compliance with internal portfolio policies. Those metrics include caps for investment by law firm, claimant, state, judge and area of law.”

Burford's philosophy is quite similar to what Annie Duke writes in her wonderful book *Thinking in Bets*. The company recognizes that both skill and luck impact litigation outcomes. This is what Burford's management said eight years before the book was published: "The very best trial lawyers will acknowledge that luck and circumstance play a role here, and that every lawyer win cases that should have been lost, and vice versa. If we shy away from risk for fear of loss, as some litigation investors do, we will not maximize the potential performance of the portfolio." Burford's portfolio is widely diversified. It had 82 separate investments with 877 underlying claims at the end of 2017. No defendant represents even 5% of commitments, and no single case's capital loss would amount to more than 2%. It work with 70% of the top 100 US law firms.

Burford is extremely selective in its investment process. In 2017, it granted only 4%, or 59, of the requests for funding. In stage one of the process, Burford receives the inquiry (1,561 in 2017) and assesses whether the economics of the case work for it. If not, it kills the idea very quickly. About 32% of those proceeded to the next stage in 2017. This is where Burford analyzes the legal merits of the case. In 2017, only 151 cases remained after that review, and those went to the investment committee, which approved roughly 40% of them.

When discussing whether Burford's returns are sustainable, consideration should be given to competition and barriers to entry. Will Burford's success invite competition? Numerous significant barriers to entry in the litigation finance industry exist, which is why I think those returns will be sustainable for many years. First, scale is needed to build a diversified portfolio. Second, scale is needed to build a top-notch team. Third, relationships are critical in litigation finance. Fourth, Burford has superior underwriting. Fifth, it's difficult to raise capital for new players if capital allocators can invest in Burford-managed funds. Finally, potential conflicts of interest prevent investment banks from entering the litigation finance industry.

An important thing to highlight is that Burford has always had competition. It's not as if it is the only one doing this; it's just the biggest, most successful, and smartest investor in the space. Burford was not even the first one - IMF Bentham was launched in 2001, and Jurdica and Harbour Litigation Funding started in 2007. Burford always had competition, but it currently manages 4x as much as its closest rival. There are no new entrants after 2015, which, in my opinion, shows how high the barriers to entry are.

One other thing to highlight is that price competition is not as fierce in litigation finance due to some structural constraints. Let's compare how the investment process works for private equity and litigation finance. In private equity investing, the owner of a middle-market business wants to sell and gets in touch with an investment bank, which receives the sale mandate. The bankers get to work, conduct diligence, do research, and produce a deck that is blasted to everybody on the planet. This creates a highly competitive sales process with auction dynamics. The process could not be more different for investing in legal claims. Sending a deck or legal memoranda with confidential information to many parties can break the attorney-client privilege. The legal counsel will need to engage in conversations with potential litigation funders. Very often, a law firm will do this free of charge or on a deferred fee arrangement basis. As you can imagine, a law firm will not want to engage in the same conversation with multiple litigation finance providers as it is not billable. As a result, the competition is not similar to private equity. Based on my conversations with lawyers, reaching out to two or three finance providers is most common.

Importantly, the entire market is expanding, so players don't feel the need to fight for market share because the entire pie is growing. That's why I think the combination of high barriers to entry, lack of fierce price competition, and a growing market means Burford's high returns should be sustainable.

Burford has two segments - litigation investments from its own balance sheet, which is the larger

segment, and investment management, which is similar to managing any other hedge fund. In 2016, Burford acquired what is believed to have been the second-largest player at the time. It had \$1.3 billion in AUM and managed only third-party capital.

How does Burford revenue recognition work for balance sheet investing? The revenue consists of realized gains and unrealized gains, which are fair value adjustments. Realized gains are simple – Burford put \$100, the case is adjudicated by the judge, Burford is entitled to get \$190, and it records a gain of \$90. It's the same with the loss. But how are the fair value adjustments recorded, and is fair value accounting appropriate? You may have all types of questions right now, such as doesn't this sound horrible and potentially open to abuse and doesn't it mean that management can come up with any amount of unrealized gains in any single reporting period? I had those questions as well, and they are totally legitimate. However, the company provides so much disclosure that shows its fair value adjustments are very reasonable and appropriate.

It must be noted that it's not Burford making those adjustments, it's IFRS that require of it to make them. Secondly, if you look at the balance sheet, only 36% of litigation investments constitute fair value adjustments. Burford is very conservative, and most importantly, it has almost never reversed an investment that it marked up first. It has happened only twice in Burford's history, and those adjustments were 0.2% of all total write-ups by dollar value. To me, it's minuscule and shows that the company is highly conservative in its accounting treatment of these gains. Another thing I would like to highlight is that Burford demonstrated very strong operating leverage as it was scaling, so its expense structure is very scalable.

The investment management business is straightforward – you've got other people's capital and deploy that. Why did Burford enter into this space? The answer is mind-blowing, in my opinion. By 2013, the company had more great opportunities to invest in than it had capital. It had to figure out how to procure more capital, so getting into the third-party fund management business was logical. Burford has implemented a very clear allocation policy: 25% of every opportunity goes to its own balance sheet, 50% goes to the sovereign wealth fund, and 25% goes to the investment funds with third-party capital.

Investors take an extremely small foreign currency risk because even though the shares are denominated in British pounds, 85% of investment activity is in US dollars.

We model Burford by doing a sum-of-the-parts analysis because it has two quite different businesses. For the balance sheet investing business, I have my bear case IRR at 20%, base case at 25%, and bull case at 30%. Just as a reminder, most recent IRRs were in excess of 30%, so my base case feels quite reasonable. My assumptions lead me to an outcome which is very conservative, and I expect Burford to perform better than that. I am putting 17x P/E on my base case, which generates a 120% upside. I think this multiple is appropriate given the strong growth, superior return on equity, and consistent increases in dividends. In the bull case, the math is even more exciting – it's 300% upside. My assumptions on the bull case are more difficult to execute, but they're definitely achievable. In my bear case, I am getting 19% negative return by 2022.

The investment management business is fairly simple, with very few drivers – the most important ones are AUM and returns. You have fees but fees we know, so that's easy to model. Even in my bear case with fairly draconian assumptions, I'm still getting to a small upside by 2022. I think there is a big margin of safety in this investment.

The following are excerpts of the Q&A session with Artem Fokin:

Q: What kind of CAGR do you expect for this industry over the medium to long term?

A: I think the industry can achieve 20% to 25% CAGR over the next 5, 7, or 10 years. It is very difficult to predict whether it will be steady growth every year or whether we will hit an inflection point, with growth jumping to 40% or 50%. It may happen. It's something worth watching. If you have lawyer friends, talk to them. Read legal industry publications. Sign up for Burford's newsletter. To answer your question, I think 25% to 30% CAGR is reasonable to expect, in my opinion. Whether we will hit an inflection point where it accelerates, we will see.

Q: It sounds like the IRRs are somewhere around 20% or 30%. Is that right?

A: The most recent IRR has been 30%, and this is important to highlight – Burford gives those IRRs by year, and they are cumulative from inception. The company launched in 2009. When it says IRR was 24% in 2013, it means IRR on investments concluded between 2009 and 2013. The most recent IRR of 31% in 2017 covers all investments concluded from 2009 to 2017. I'm modeling 25% going forward, so I think my model in the base case is very conservative.

Q: Given the high IRRs, why wouldn't a company like Burford, which is very good at this, keep it a secret and just compound its own capital? You're making 30% IRR – take that and reinvest it in this thing. If the industry is growing at around 20% to 30%, you can just do it with your own capital. Why potentially put more pressure on returns by having more capital chasing these deals and it's not your own capital?

A: Terrific question. Burford raised money in 2009 when it went public. From there on, it kept investing, and it started running into a problem – there were more great cases than it had capital to invest in. There were too many opportunities, and it started exploring how it could get more capital. Burford placed some public bonds into the market, which was one source of capital. However, the company is surrounded by lawyers, who are conservative people by nature and didn't want to lever up too much. The other option to have capital for investment would be to raise money from someone else in a hedge fund structure. That's what Burford did.

I would also point out that having third-party capital is amazing for Burford from a risk management perspective because it allows the company to take bigger cases. There are some giant legal cases in the industry, with legal bills running at \$50 million to \$80 million. If you take the entire case for \$80 million or \$100 million, that's a huge ticket price. Litigation outcomes are binary. You can lose. If you lose \$100 million, that's painful. In other words, there are concentration limits on your positions. Now, Burford can take that \$100 million case and spread it amongst several pools of capital based on its formula – 25% to its own balance sheet, 50% to the undisclosed sovereign wealth fund, and 25% to another hedge fund it manages. Burford can take a massive case without putting its concentration limits on positions in danger. That's another beauty and benefit of running other peoples' money.

About the instructor:

Artem Fokin is the founder and portfolio manager of Caro-Kann Capital LLC, a hedge fund based in San Francisco. Prior to founding Caro-Kann, he was a principal at Outrider Management LLC. Before entering the investing industry, Artem was an attorney with Greenberg Traurig LLP in New York City. Artem earned an MBA from the Stanford GSB (Arjay Miller Scholar), a Master of Laws degree from NYU School of Law (Newman Scholar) and a bachelor of law from the Higher School of Economics (Presidential Scholar) in Russia. Artem is admitted to the practice of law in the State of New York and is a dual citizen of the United States and Russia. Caro-Kann Capital LLC is the general partner of an investment partnership based on the principles of value investing that focuses primarily on special situations and compounders. Caro-Kann Capital is named after a chess defense that emphasizes

building safety and defensible position before contemplating an offensive strategy. The Founder's substantial legal experience brings a greater ability to analyze complex corporate documentation accompanying extraordinary corporate events. The Fund's core investment principles include: (1) concentration when properly compensated, (2) risk is not equivalent to volatility, (3) non-economic selling can lead to attractive opportunities; (4) capital allocation is often underappreciated by the market, and (5) incentives and insider ownership are paramount.