Research Update:

Burford Capital Ltd. Assigned 'BB-' Rating; Outlook Is Stable

November 1, 2019

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Overview

- Burford Capital Ltd. (Burford) provides specialized financial services to the legal market by offering financing to lawyers and clients engaged in litigation and arbitration, asset recovery, post-settlement receivables, and other legal finance and advisory activities.
- Credit positives include Burford's leading market position in litigation finance, its relatively low leverage, and its strong track record of investment returns since inception in 2009, while the unpredictability and lack of principal protection for litigation finance investments and potential liquidity risks are credit weaknesses, in our view.
- We are assigning our 'BB-' long-term issuer credit rating to Burford Capital Ltd.
- The stable outlook reflects our expectation that Burford over the next 12 months will maintain leverage of under 1.0x as measured by debt to adjusted total equity and its favorable investment returns.

Rating Action

On Nov. 1, 2019, S&P Global Ratings assigned its 'BB-' long-term issuer credit ratings to Burford Capital Ltd., Burford Capital LLC, and Burford Capital Global Finance LLC. The outlook is stable.

Rationale

The ratings reflect Burford's leading market position in the litigation finance niche, its relatively low leverage, and its strong track record of investment returns since inception in 2009. Conversely, the ratings also reflect the binary nature of investment outcomes in litigation finance investing with little principal protection, and the potential liquidity risks associated with a large amount of unfunded commitments combined with a highly illiquid investment portfolio that yields unpredictable litigation investment realizations.

We believe that Burford benefits from the low cyclicality of litigation finance and its lack of correlation with overall economic activity. Burford's business has been growing at high double-digit rates over the past five years, but the company's high growth, lumpy litigation investment realizations, and the nascent nature of the niche legal finance industry introduce additional business risks, in our view. The more recent focus on investment management, as evidenced by the new Burford Opportunity Fund and Sovereign Wealth Fund, helps partly mitigate those risks; however, the expected contribution to revenue is small in the near term. Burford's future growth depends on its ability to continue originating legal matters with the desired duration and return profile.

As of June 30, 2019, Burford's investment portfolio consists of over 110 separate ongoing investments. Although the portfolio is concentrated in litigation finance, we believe that its large portfolio provides some inherent revenue diversification. Conversely, the asymmetric return profile means that among all concluded litigation finance investments from the company's inception in 2009 to June 30, 2019, the top five investments by realizations account for about 38% of total realizations.

We view Burford's use of leverage as conservative. The company's leverage, as measured by debt to adjusted total equity (ATE), was 0.46x as of June 30, 2019. We deduct intangibles in our measure of ATE. We expect Burford's leverage to remain below 1.0x, which is lower than many rated finance company peers. We expect Burford's aggregate earnings to remain strong, with a projected return on average assets of 15%-20% over the next 12 months, comparing favorably with many rated finance company peers.

The binary nature of litigation finance investing with little principal protection presents potential risks to Burford, in our opinion. The company's litigation finance investments can result in a near-complete loss of its initial investment (about 12% of concluded cases by deployed capital since inception to June 30, 2019). In total, about 17% of concluded legal matters (by deployed capital) recovered less than their invested deployments across the same period. On the other hand, the very favorable payout profile of winners versus losers means that on a portfolio level, the company has generated strong positive returns. We believe that while Burford has benefited from the very asymmetrical return profile of its investments, the lack of principal protection for litigation investments and the high percentage of cases that resulted in losses highlight potential risks to the company.

As of June 30, 2019, Burford's funding consists primarily of $1.4 billion of tangible equity and four retail bonds totaling $638 million, with no near-term refinancing or maturity risk. Favorably, the company does not rely on any short-term funding. On the other hand, we believe that Burford's liquidity could be strained in a potential stress scenario, given the unpredictability of the timing and amount of litigation investment realizations, and the growing amount of undrawn commitments. In a stress scenario where the company has reduced market access, accelerated draws on commitments, and displayed a decline in litigation investment realizations, we believe Burford might struggle with funding undrawn commitments and committing capital to new investments. Although the company does have the ability to quickly divest from complex strategy investments, the rest of its portfolio remains largely illiquid. Additionally, divesting from complex strategy investments would eliminate all potential upside for those investments and incur realized losses from the short positions and legal fees.

Our ratings on Burford Capital LLC and Burford Capital Global Finance LLC reflect our views that they are core subsidiaries of Burford. Burford conducts its U.S. operation via Burford Capital LLC, and Burford Capital Global Finance LLC is a financing subsidiary of Buford Capital LLC. We believe Burford is likely to support these entities under any foreseeable circumstances.

Outlook

The stable outlook reflects our expectation that as Burford continues to grow both its balance sheet and investment management businesses, the company will be able to maintain its currently favorable investment return profile where, despite a relatively high number of failed investments, the successful investments provide more than sufficient compensation because of their asymmetric return profile. The stable outlook also considers Burford's low leverage (debt to ATE of 0.46x as of June 30, 2019) and our expectation that it would remain below 1.0x over the next 12 months.

Downside scenario

We could lower our ratings on Burford if leverage increases beyond 1.0x on a sustained basis. We could also lower the ratings if we believe that Burford's investment performance weakens considerably, which could be indicated by lowered investment realizations over a six to 12 month period or by a rise in the ratio of cases that are concluded with a return less than invested principal.

Upside scenario

We view an upgrade as unlikely over the next 12 months. Over the longer term, we could upgrade the company if its portfolio reaches a maturity and diversification that would reduce potential lumpiness of revenues and provide a more stable and predictable flow of earnings.

Ratings Score Snapshot

Issuer Credit Rating: BB-/Stable/--

SACP: bb-

- Anchor: bb+
- Entity-Specific Anchor Adjustment: 0
- Business Position: Moderate (-1)
- Capital, Leverage, and Earnings: Very Strong (+2)
- Risk Position: Weak (-2)
- Funding and Liquidity: Adequate and Moderate (-1)
- Comparable Ratings Adjustment: 0

External Influence: 0

- Government Influence: 0
- Group Influence: 0
- Rating Above the Sovereign: 0

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

New Rating; Outlook Action	
Burford Capital Limited	
Burford Capital LLC	
Burford Capital Global Finance LLC	
Issuer Credit Rating	BB-/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.