As we spoke at length in last quarter's letter, Burford Capital is a litigation finance company; they fund high-end commercial disputes in exchange for a portion of the proceeds recovered. Although Burford has a widely diversified portfolio of multiple legal claims, it cannot be denied that there is intense investor interest in Burford's largest litigation, one with the potential to return multiples of Burford's market cap. Despite the intense interest and speculation surrounding the Petersen and Eton Park cases, there is little public analysis available as to their potential valuation, and much of what is publicly available contains serious errors. We have therefore undertaken to provide a complete breakdown of the Petersen and Eton Park claim valuations.

Background

YPF is the national oil and gas company of Argentina. Its stock trades in Argentina in pesos as well as through an ADR that trades on the NYSE in dollars. When Argentina privatized YPF in 1993, Argentina and YPF made a series of promises to investors about their future conduct, which included obligating Argentina to make a tender offer to shareholders if it later chose to re-nationalize YPF. In 2012, Argentina ignored that promise and expropriated a controlling stake in YPF without making the required tender, causing the market value of YPF's shares to fall sharply. This in turn caused the Petersen Group, which consisted of two Spanish companies that collectively held an interest of just over 25% in YPF, to become insolvent. Argentina was subsequently sued in New York by Repsol, then the majority owner of YPF with an interest slightly over 50%, and Argentina settled that lawsuit for around $5 billion. Petersen, with a holding of around half that of Repsol's, has since brought a similar lawsuit, with financing from Burford. In addition, Eton Park, a hedge fund which owned around 3% of YPF, is also being financed by Burford in a separate but parallel lawsuit.

Burford's Entitlement

Burford is funding Petersen's legal fees in exchange for 70% of the proceeds. Burford is contractually obligated to provide the litigating law firms success fees and other expenses, and Burford therefore expects to retain 58-59% of the gross proceeds. In addition, Burford has over time sold 38.75% of their net entitlement (i.e., 38.75% of the 58-59%, *not* of the gross proceeds, as I have seen some analysts mistakenly asserting) in exchange for $236 million, retaining 61.25% of their original entitlement for their own book. Thus, Burford should receive just under 36% of Petersen's gross proceeds (58.5% * 61.25% = 35.8%). As of the end of 2020, Burford has paid legal fees of $21.7 million for the Petersen case, which will continue to increase as the case proceeds through the legal system.

In the Eton Park case, Burford paid $26 million in exchange for rights to 75% of the proceeds, all of which Burford retains on their own book. Eton Park was a much smaller shareholder than Petersen (3% vs. 25%), but because Burford retains its entire Eton Park entitlement, Burford's Eton Park entitlement is approximately a quarter of their Petersen net entitlement. (Eton Park gross proceeds = 12% of Petersen gross proceeds [3% / 25% = 12%]. Burford's entitlement for Eton Park is then 9% of Petersen gross proceeds [12% * 75% = 9%], which is a quarter of the 36% of Petersen gross proceeds that Burford is entitled to from the Petersen proceedings.) For simplicity's sake, we will calculate Burford's Petersen entitlement and simply add a further 25% to account for their Eton Park entitlement.

Valuation According to YPF Bylaws

YPF's bylaws, mutually agreed to by both Argentina and YPF, and referred to multiple times in the

IPO and ADR process, call for valuing YPF's shares in case of a nationalization by Argentina through a variety of methods, whichever is higher. The formula of interest in the present circumstances is thus:

> "The net income of the Corporation per each share of the Class during the last four complete fiscal quarters immediately preceding the Announcement Date, multiplied by the higher of the following ratios: the price / income ratio for that period for the shares of stock of the Class (if any) or the highest price / income for the Corporation in the two-year period immediately preceding the Announcement Date. Such multiples shall be determined using the regular method used by the financial community for their computation and reporting."

The necessary inputs to calculate this formula are the income for the preceding four quarters preceding the Announcement date and the Price/Income ratio for the stock for the preceding two years, which itself needs both Price and Income inputs to calculate. Despite the seemingly precise formula given, some ambiguity remains in trying to calculate the formula.

Questions to Consider in Calculating Formula:

There are a number of ambiguities and questions needing to be resolved to use the above formula to calculate a precise figure for the required tender offer.

1. When is the correct Announcement Date?
2. When calculating the Price/Income Ratio, should we use the share price of the YPF shares trading on the Buenos Aires exchange or of the ADR traded on the NYSE?
3. When calculating the Price/Income Ratio, should we use the highest intra-day share price or the highest closing share price?
4. When calculating the Price/Income Ratio, should we use the income calculated in Argentinian pesos or in US Dollars?
5. When calculating the Price/Income Ratio, should we use the income of the last four quarters or of the last four quarters of financials reported to the public?
6. After arriving at the proper ratio, we now need to multiply by the last four quarters of income. Should we use the income of the last four quarters or of the last four quarters of financials reported to the public?
7. Should we use the income calculated in Argentinian pesos or in US Dollars?
8. Whenever using US Dollars, should we use the exchange rate of the date in question, the average rate for the quarter, the average rate for the whole year, etc.?

Of these questions, Questions #1, #5, and #6 are the most important in calculating an approximately correct figure for the valuation formula. The remaining questions are more nitpicky and in the present circumstances do not substantially change the final figure.

We will begin with the ambiguity surrounding the Announcement Date, defined elsewhere as "the first public announcement of the Related Transaction". Burford claims that the proper date is in January 2012, when press reports surfaced of Argentina's plan to expropriate YPF shares. This would be using an Announcement Date of January 27, 2012. As Burford themselves point out, Argentina may argue that the correct date to use would be in April, when the Argentinian parliament officially announced the expropriation plans and introduced a bill to that effect. This would be using an Announcement Date of April 16, 2012. Personally, we consider this latter view to be more persuasive. Nevertheless, we will calculate the valuation using both possible Announcement Dates.

Burford has publicly stated that using the January date reaches a gross valuation (for Petersen's claim against Argentina, not for Burford' entitlement thereof) exceeding $9 billion, but that using the April date reduces the valuation to under $6 billion. I have seen published analyses that reach valuations of $5.7 billion and $4.7 billion respectively, ostensibly using the same formula and Announcement Dates as Burford. Needless to say, these numbers are significantly different that Burford's numbers.

The discrepancy lies in how they each approach Question #5, i.e., which income to use in calculating the Price/Income ratio. The outside analysis looks back two years from the Announcement Date and calculates the share price each day divided by the prior four quarters' income. They do not take into account that for a significant period of time after each quarter end, the shares trade in the market without knowledge of the immediately ended quarter's results until they are announced publicly by the company. Burford's calculations are apparently using the last four quarters of *reported* financials.

We believe that it is obviously true that the Price/Income ratio that the stock is trading in the market can only be calculated from publicly announced financials. Stocks do not and cannot trade on multiples of income that market participants do not yet know. This clearly follows the bylaws' dictate that "such multiples shall be determined using the regular method used by the financial community for their computation and reporting." In the present circumstances, this crucial difference changes the valuation significantly, and we believe Burford is entirely correct in their approach.

For sake of clarity, although we believe it is obviously correct to calculate the Price/Income ratio using reported financials (in answer to Question #5), when then multiplying this ratio by the 4 quarters of income preceding the Announcement Date, we believe it is correct to use the most recently ended quarter, even if not yet reported (in answer to Question #6).

Valuation of Petersen Claim

Using an Announcement Date of January 27, 2012, the highest Price/Income ratio over the preceding two years is 27.95 (on March 5, 2010). Using an Announcement Date of April 16, 2012, the highest Price/Income ratio over the preceding two years would be 19.08 (on May 3, 2010). Also affected by the choice of Announcement Date is the figure for the preceding four quarters' income, which is then multiplied by the correct Price/Income ratio to reach the correct valuation. Using the January 27, 2012 date, the preceding four quarters would end with the fourth quarter of 2011. The EPS for 2011 was 13.47 Argentinian pesos = $3.283 (using the average quarterly exchange rate to translate each quarter's income from pesos to dollars). Using the April 16, 2012 date would change the last four quarters to end with the first quarter of 2012, with a corresponding EPS of 12.25 Argentinian pesos = $2.915.

Multiplying the Price Income ratios with the corresponding EPS figure yields a valuation of $91.76 for the January 27, 2012 date (27.95 * $3.283 = $91.76) and a valuation of $55.62 for the April 16, 2012 date (19.08 * $2.915 = $55.62). Petersen's 100,145,077 shares are then valued at ~$9.2 billion for the January 27, 2012 date or ~$5.6 billion for the April 16, 2012 date. We can quibble whether to calculate the Price/Income ratio with the share price in pesos or in dollars and with the precise exchange rates to use in translating the financials from pesos to dollars, but these quibbles will not change the big picture substantially.

Valuation of Burford Entitlements

Using the above valuation figures for Petersen's claim, we can then easily calculate Burford's net entitlement. As stated above, Burford is entitled to ~36% of Petersen's proceeds, and then an additional 25% of that for their Eton Park entitlement. Using the $9.2 billion figure for the Petersen claim valuation, this equates to ~$4.1 billion ($9.2 billion * 36% = $3.3 billion * 1.25 = $4.1 billion). Using the $5.6 billion figure for the Petersen claim valuation, this equates to ~$2.5 billion ($5.6 billion * 36% = $2.0 billion * 1.25 = $2.5 billion).

The range of outcomes and the resulting entitlement for Burford are illustrated in the chart below.

Potential Outcomes of YPF Litigation

($, in millions)

	Equivalent to Repsol Settlement	Announcement Date of April 16, 2012	Announcement Date of January 27, 2012
Hypothetical value of total Petersen claim	2,500	5,600	9,200
Burford remaining net entitlement from Petersen	900	2,016	3,312
Burford net entitlement from Eton Park	225	504	828
Total YPF-related net entitlement to Burford	1,125	2,520	4,140

+ Statutory pre-judgment interest rate (approximately doubles above figures)

Statutory Pre-Judgement Interest

In addition to the claim itself, Petersen and Eton Park, and hence Burford, are entitled to pre-judgement and post-judgement interest. Post-judgement interest varies with prevailing interest rates, which, of course, are presently quite low. There is also no way to predict in advance how much post-judgement will accrue, if any. Pre-judgement interest, however, is set by New York statute at 9% and is mandatory in breach of contract cases or cases involving "an act or omission depriving or otherwise interfering with title to, or possession or enjoyment of, property", which precisely fits the case here. This mandatory 9% interest, although not compounded, adds up to a significant sum. We are already nine years from the cause of action (the 2012 expropriation) and by the time the case likely comes to trial next year, we will be around ten years from the cause of action, just about doubling the headline figure above. Although some might see the statutory interest rates as being punitive at times, New York courts have always abided by the statutory rate and all constitutional challenges to it have failed.

Award in dollars or in pesos?

There remains one major risk that will be decided at trial, whether the amount owed Petersen and Eton Park should be denominated in pesos, YPF's base currency, or in dollars, the currency of the ADR's IPO that included promises of tender. If the award is ultimately denominated in Argentinian pesos, the award would be worth only 5% of the above headline figure, since the Argentinian peso has depreciated vis a vis the dollar about 95% since the events in question. We believe this is the biggest risk Burford is facing at trial, although we believe that they are likely to prevail on this matter as well.

Taxation

Burford is highly tax advantaged. Depending on the precise structure of their agreements, the underlying jurisdiction, and other such factors, they often pay minimal or no tax on their capital gains or other income. In the specific case of Petersen, based on their past tax payments (from their massive realized gains in 2019 from selling part of their Petersen entitlement) as well as based on the tax accruals on their balance sheet for their remaining Petersen entitlement, it is apparent that they owe minimal or no tax on Petersen gains. Whatever Burford walks away with falls straight to the bottom line.

Settlement and Post-Award Maneuvering

The above analysis is purely an analysis of the potential award at trial. If the parties choose to settle, they will obviously do this at a discount to the potential award, due to trial risk as well as collection risk. Additionally, if they agree to settle, the statutory interest rate will be superseded by whatever their settlement agreement calls for. We have no particular insight into either Argentina's or Burford's strategies. (We should really say Petersen's and Eton Park's strategies, as they are the litigant and they retain full control of the case and the decision whether to settle.) Nevertheless, we would not be surprised if the parties settle on the eve of the trial, at the eleventh hour, so to speak. In terms of quantum, we would not be surprised to see a settlement that would net Burford in the $2-$3 billion range (which equates to an approximately $5-$7.5 billion settlement from Argentina to settle both cases), in exchange for immediate payment, although we again stress that we have no insight into either of the parties' strategies.

If the matter indeed goes all the way to trial and Burford wins in the courtroom, then the pre-judgement interest rate would kick in to approximately double the award, as laid out above. However, if the matter is ultimately decided by trial, we would expect to see Burford sell a substantial portion, perhaps even all, of their remaining entitlement to third parties interested in pursuing Argentina for collection. Although Burford has a division specializing in asset recovery and enforcement, prudence would still dictate that they should de-risk and diversify such a massive award if they win. At the moment, they are contractually barred from selling more than half of their entitlement through the end of the case (including all appeals). As mentioned above, they have already sold close to 40% of their entitlement. In the event they win and all appeals are exhausted, we would expect Burford to sell the judgement at a discount, similar to what they did in the Teinver case, where they sold their ~$140 million entitlement (from an arbitral award against Argentina in a different expropriation case) for $107 million, a discount of ~25%. If they would sell a judgement in this case, they may need to offer a larger discount because of the massive size of the award, and this would counter some, although probably not all, of the gain they would make from pre-judgement interest.

Conclusion

In conclusion, we would like to remind all our readers that even if Burford does not make another penny from the Petersen and Eton Park cases, they have already profited from them quite handsomely, having pocketed $236 million in cash on an investment of under $50 million to date. Any way you look at this, this was a huge win for Burford, one of many similar very successful wins. Although investors are often super-focused on Burford's success in Petersen so far, the truth is they have had similar massive wins in the past and have other ongoing cases that have the potential to be massive wins of similar size to what Petersen has brought in so far, even if none can quite approach Petersen's future potential. Burford has proven itself time and time again to be a prudent and successful investor in the rapidly growing field of litigation finance.

We do not suggest that investors should invest in Burford solely on the basis of their potential Petersen/Eton Park entitlements. That said, Burford is presently trading at $10.73 (as of Friday, July 16th), a market cap of ~$2.3 billion. As explained in detail above, Petersen and Eton Park have the potential to return to Burford substantially more than $4 billion. The potential to return multiples of Burford's market cap from one set of cases is definitely an excellent icing on top of the ongoing successful and growing business that Burford has built.