April 2023

Dear Fellow Investors,

The Fund[1] returned approximately 17% in the first quarter. Returns will vary by fund and investment class, so please check your statements. As fears of runaway inflation waned during the quarter, there appeared to be some return to focusing on the individual businesses underlying the shares of stocks we own. Given the instability in the banking sector, a looming debt ceiling fight in the U.S. Congress, and the likelihood of a recession, the macro environment may not have fully loosened its grip on investor psyche, but the reprieve has been welcomed.

On a shelf in my office sits a small white elephant bought during a trip to Agra, India with my middle daughter. Agra is the city where the Taj Mahal was built almost 400 years ago. In theory, my elephant is made of marble similar to that used in its construction. The cooperative where we purchased the figurine went to great lengths to show us how much craftsmanship was involved and how much stronger their marble is than the less expensive, machine-made soapstone sculptures available at the airport and other touristy locations. The salesman used a piece of metal to scrape away at a competitor's soapstone, which produced significant dust while his marble reflected virtually no impact. The implications were clear, I could find a less expensive option elsewhere, but it would be neither as durable nor as vibrant over time. He was selling a Taj Mahal strong elephant and it was worth the premium price.

When I look at my elephant, I do typically wonder how much I "overpaid" for it given the time pressures of being in town for just one day, and the inherent information asymmetry of the transaction. I like to tell myself I overpaid by 30%, but that may be very wishful thinking. Fortunately, the dollar amount was small and the elephant elicits fond memories, which soften the pain of overpaying.

I also look at the elephant and wonder about its durability. How different is it *REALLY* from the airport elephants? Will mine really look the same in 20 years? In 40 years? Would theirs? Is there any real difference in the craftsmanship or durability? Unfortunately, I did not have the foresight to buy a "cheap" elephant to run a proper experiment.

Thoughts about my elephant's durability inevitably lead to thoughts about the durability of companies in our portfolio. At Greenhaven Road, we are not day traders – we invest with a long time horizon. The largest predictor of our returns will be the long-term durability of the growth and earnings power of the companies which make up the bulk of our portfolio.

Virtually every company puffs its chest out and claims to be built with the equivalent of Taj Mahal marble. However, less than 20% of the original S&P 500 companies remained in the index after the first 50 years. The failure rate for the smaller companies we focus on is even higher, as is their vulnerability to a recession. Which of our holdings are Taj Mahal strong? Which are soapstone pretenders? Both can be profitable in the short term.

LARGEST HOLDINGS

In the last letter, I tried to analyze the top holdings through the lens of "fundamentals" with the mantra of "fundamentals matter". Implied in the argument that "fundamentals matter" is an assumption that the fundamentals will persist. A particular scourge to investors are "value traps" that always appear well-priced but continue to underperform because of

[1] Greenhaven Road Capital Fund 1, LP, Greenhaven Road Capital Fund 1 Offshore, Ltd., and Greenhaven Road Capital Fund 2, LP are referred to herein as the "Fund" or the "Partnership."

ever-deteriorating fundamentals. The difference between a value trap and a beautiful compounding machine is the durability of the revenue growth and earnings.

In this letter, I want to look at our portfolio through this lens of durability. While there are quantitative indicators of durability such as low customer churn, this analysis will be more qualitative. Before we engage in this exercise, there is an important caveat. I am trying to build a portfolio of "different bets" so not everything we own will be optimized for durability. We will own special situations such as spin-offs and companies where GAAP accounting is hiding the fundamentals. This is not a "durability at all costs" portfolio, but just like fundamentals matter, durability does too.

In the last two letters, I have written about attributes I believe permeate our largest holdings. As a reminder they are:

> **Low Churn** – Predictable/stable demand makes it easier to manage a company through a downturn as it significantly reduces the likelihood of revenue falling off a cliff.
>
> **Secular Tailwinds** – Even in a recessionary environment, secular tailwinds can provide company-specific growth despite a shrinking GDP.
>
> **Positive Product Lifecycle Dynamics** – A combination of new products or products that are early in their adoption curve can provide growth, even in a weak economy.
>
> **Operating Leverage** – When combined with revenue growth, operating leverage should lead to accelerated profitability. We don't own companies with broken unit economics that are growing for growth's sake. Instead, we own companies with strong unit economics that are scaling and over time (as they hold down general and administrative, development, and marketing expenses), the companies' profitability growth should exceed their overall growth rate.
>
> **Strong Balance Sheets** – None of these companies are reliant on the markets to fund their operations. They have years of cash to operate and are either profitable or quickly approaching profitability.

Of these five attributes, low churn and strong balance sheets are most indicative of durability, while secular tailwinds, positive product lifecycle dynamics, and operating leverage are supportive of revenue and earnings growth.

PAR TECHNOLOGY (PAR) – PAR ended 2022 with over $100M in cash on the balance sheet and no significant debt maturities until 2026. The company continues its march towards profitability, which is an important precursor to long-term survival. During the first quarter, PAR reiterated their commitment to hold expenses flat in their software business while continuing to grow revenues. By my estimates, PAR should grow annual recurring revenue (ARR) by +/- 30% for the foreseeable future. This revenue should drop to the bottom line, making the overall company profitable by the end of this year and the software business itself profitable by early next year.

PAR benefits from low single digit churn on their core point of sale (POS) offering, which is important for longer-term growth since the bottom of their proverbial bucket is not leaking. Their competitive landscape is also favorable: their primary competitors are legacy systems from NCR and Oracle, for both of which POS systems are tertiary products. While there will be increasing competition from the likes of Toast and Square, developing and selling products for enterprise restaurants is different, and I believe PAR should be able to continue managing the landscape adeptly.

There are three future sources of growth for PAR that, when paired with the low churn of their existing customers, bode well for future growth. This quarter, PAR announced the signing of a 900-location chicken wing restaurant for their new

table service product. Moving into table service restaurants greatly expands their market, and these installations will start rolling out this year. A second leg of growth will come from an online ordering offering from MENU, a company they acquired in 2022. The third leg of growth will be the continued rollout of PAR's payments product across its installed base. Interestingly, PAR has begun talking about an opportunity with the largest fast-food chains, which historically have built and maintained POS systems in house. As the need to integrate with multiple delivery services, maintain online ordering, support a robust loyalty program, and feed data into analytics platforms has intensified, the cost/benefit of developing in house is not as clear cut even for the large players. PAR currently has approximately 20,000 POS locations. There are 12,000+ Burger Kings. Winning a Burger King size customer would be material and those types of opportunities may very well start to materialize. There are several paths to sustained growth and profitability.

When CEO Savneet Singh took over at PAR, the company had a single POS product with angry customers who were locked in. There has been a multi-year effort to stabilize the core product, make acquisitions, and now develop new products. PAR is committed to making all the disparate technologies required to run a restaurant work together seamlessly under the umbrella of Unified Commerce. They are designing their products such that they work on a standalone basis but are even more valuable to the end user when used in conjunction with other PAR products, taking advantage of shared data and expanded functionality. For example, PAR's payments offering is better when paired with POS as it greatly simplifies troubleshooting and reduces costs. Payments also improves the loyalty product as it feeds additional data into the platform. The goal when using PAR products together is for this improved functionality to reduce churn and increase cross-selling. Each step in the product evolution, from stabilization to Unified Commerce, is a step towards greater resiliency and durability of the overall company.

To summarize, PAR has multiple sources of growth with their existing business. The new table service offering, MENU acquisition, burgeoning payments offering, and potential migration of the largest operators to third-party software are just a few of the opportunities ahead. We can argue about the timing of adoption, magnitude of the opportunity, and appropriate multiple, but in my mind, this is a business that has been in the gym training for the last four years and has now begun to quietly kick ass.

KKR (KKR) – Given the concerns in the financial markets about a banking crisis and a run on banks, share prices of all "financials" declined during the first quarter. KKR was not spared, falling more than 10% as the Silicon Valley Bank saga unfolded with a parade of outflows triggered by some tweets, texts, and a few clicks in their apps. Other than being in the financials category, KKR could not have less in common with SVB. At KKR, capital is pooled in over 100 vehicles and can only leave KKR if there is an investment realization or the firm proactively decides to return the capital. In fact, over 45% of the fee-paying capital is permanent, and there is over $100B in "dry powder" that KKR will call when ready to invest in new opportunities. Private equity with permanent capital and mountains of dry powder is one of the most durable businesses I can imagine. KKR can and likely will outlast us all.

Cellebrite (CLBT) – Cellebrite is an Israel-based company that came public via a SPAC and is half-owned by a Japanese company. In other words, it has three strikes against it before we even get started. However, Cellebrite has also been a self-funding, rapidly growing technology company since before it was fashionable. They have almost $200M in cash and investments, single-digit churn, gross margins north of 80%, and net revenue retention that has consistently been 125% or greater. Their GAAP reported growth has been depressed due to accounting rules for on-premise licenses and their transition from selling perpetual licenses (large up-front payment) to Software as a Service (SaaS).

As the market leader in "collect and review," Cellebrite provides the tools law enforcement needs to gather digital evidence from cellphones. Their products help manage the data, track who has accessed it, document compliance with the terms of a search warrant, and make sense of the mountains of data, which generally include geolocation, contacts, texts, phone calls, voicemails, image metadata, and other social media data. The unit economics are excellent and, as the scaled player,

Cellebrite can invest more in R&D than smaller competitors. The competitive landscape is limited, most agencies multi-source (using two or more providers), and there is product lock-in as use requires training. A trained/certified technician carries more weight when testifying in court, so many labs put their users through training.

Crime is not going away, digital devices are not going away, and law enforcement's need for tools to help connect data and criminals will only grow. Cellebrite's customers are government agencies not subject to the same whims as a consumer and Cellebrite sells products that are mission critical. Can you picture a day where police departments will not have to document compliance with a search warrant of a phone, or one where law enforcement conducts investigations without looking at a subject's phone? In the first quarter, Thoma Bravo completed their acquisition of Magnet Forensics, a Canadian company also in the digital investigation space. While this isn't a direct competitor to Cellebrite, I find it notable that they paid multiples of where Cellebrite currently trades. Cellebrite is not going away anytime soon unless private equity or Axon (which already owns 5%) acquires it. Strong balance sheet, strong end markets, strong product line-up, limited competition, scaled player – maybe not Taj Mahal strong, but this is nowhere near a typical soapstone SPAC.

API Group (APG) – API Group has two business lines: Safety Services and Specialty Services. Specialty Services is an okay business. Their end customers are primarily telecom and utilities, and API Group will handle services such as: electric and gas utility maintenance, water line and sewer installation, and underground electrical/fiber optic cable installation. These are mission critical projects from large stable customers – with a significant backlog. The company has indicated a desire to sell this business and focus on their crown jewel, Safety Services, which is focused on fire safety systems. The inspection and maintenance of these systems is statutory; it is required by law, thus non-discretionary, with enforcement typically coming from the fire marshal. The cost of losing the use of a facility is massive compared to the expense paid to API Group for maintaining compliance. An asset light, profitable, legally mandated business that has consistently grown organically is an excellent business, hence our long position. API is in the process of digesting a large acquisition and currently has an elevated debt load, but I believe they will successfully navigate the transition and reward shareholders along the way.

Burford Capital (BUR) – This is a new holding that is discussed in greater detail at the end of the letter as an appendix. Burford finances commercial litigation. It is the largest player in the industry, has the best deal flow, has the best data, and has supplemental capabilities such as collections that give it a structural advantage. Given the sensitive nature of legal cases, there are unlikely to be auction situations, and Burford should continue to get opportunities where they are the sole bidder. Given the structure and incentives of law firms, litigation finance is likely to continue to grow. Burford has a very strong balance sheet and also manages third-party capital. They have compounded their own capital in excess of 25% for well over a decade and do not rely on the capital markets. Absent a significant change in the law or a change in human nature, I believe that Burford should have an advantaged position for a very long time.

ELEPHANT HUNTING

I just spent pages discussing durability and its importance. I believe that over 80% of our capital, including all the companies listed above, is well-positioned for the long term, and I would sleep well knowing I had to hold these positions for five years. However, as this is the preponderance of my life savings, I also want to have a diversification of bets. We have the ability to invest anywhere, and markets are inefficient, so we also are invested in a couple of special situations. These are smaller positions because the risk of losing capital is higher on a relative basis, but I believe they could be worth multiples of their current share prices. This is big game hunting.

Lifecore (LFCR) – Lifecore was previously called Landec and had two businesses. The first business was what I would affectionately call a crappy avocado business with volatile earnings due to both variations in crop size and pricing. After

several fits and starts, they have finally divested it. The other business is a contract development and manufacturing organization (CDMO) which manufactures drugs for pharmaceutical companies. This is a specialized activity and since certain classes of drugs need to go through a reapproval process if the manufacturer is changed, it makes an excellent business with real switching costs and barriers to entry.

Lifecore is the manufacturer of 29 different FDA-approved products, which provides diversification but also leads to lumpy results as margins vary by product and utilization varies from quarter to quarter. In March, the company announced that it would miss earnings and, as a result, put it in violation of its debt covenants. The market reacted violently, sending the shares down a whopping 67%. Around the same time, Lifecore also announced the largest customer win in its history, a prepayment of $10M by the new customer, and the initiation of a strategic review process to sell the company. There is an activist investor who owns 9.9% of the company. Now, the sale of the company is really just a sale of the high quality CDMO business.

In the past, CDMO assets have traded at 10-20X EBITDA. Depending on how you view the new customer win and certain margin assumptions, I believe that a range of $8-20+ is possible for the equity. We invested a bit under 2% of the Fund at a sub-$3 share price, or a sub $100M valuation.

Matt Sweeney of Laughing Water Capital and Adam Patinkin of David Capital were helpful in explaining the opportunity and potential investor misperceptions. Both have been to the Partners Fund events at the Ocean House.

Barnes and Noble Education (BNED) – Retailing tends to be a bad business. While there are exceptions such as Walmart, which benefits from scale and local monopolies, retailers are not particularly durable. Barnes and Noble Education operates college bookstores. In the 1990s, this was a good business but today it is not. College students increasingly buy their books from other sources such as Amazon, use pirated PDFs from dubious websites, or do not procure books at all for cost or logistical reasons. The combination of declining enrollments and declining rates of book purchases has decimated the company's earnings and effectively made it a nonprofit today, operating 793 physical bookstores and 606 virtual bookstores serving 6M students, generating $1.5B in revenue… and no profits.

Why did we invest incremental capital into Barnes and Noble Education this past quarter? The short answer is that they are likely to be a much more durable business in two years. Why? How? Four years ago, they launched First Day Complete, a program where they partner with schools and publishers to provide all of a student's books (physical and digital) billed directly through the school. Because of publisher discounts, students save 30-50%, schools receive a commission on the book sales, and publishers are actually paid for their products. It's a win-win-win.

Make that a win-win-win-win: It is particularly beneficial for Barnes and Noble Education. To date, when schools convert from a traditional bookstore to First Day Complete, Barnes and Noble Education sees a 90% increase in revenue and a 130% increase in gross profit for that location. While the unit economics of First Day Complete are transformative, unfortunately, less than 20% of schools are currently on the platform. Earlier this year, Barnes and Noble acknowledged that their old model was broken and they were going to aggressively work on converting schools to the program. With the exception of the handful of very profitable locations, conversion would be mandatory. Given an industry structure with limited competition, and the fact that First Day Complete is not only a win for students but also generates more revenue for schools, I think it is highly likely that enough schools convert to realize the improved economics.

Barnes and Noble Education has an activist investor that owns more than 10% of the company, which makes up a disproportionate amount of their fund. In other words, they care about the outcome. It appears that they are driving the move to First Day Complete, as well as a company commitment to stop burning money on its Bartleby unit.

BNED is followed by just two sell side analysts, has a sub-$100M market capitalization and, as best as I can tell, the number of people modeling the company's economics if they are successful with the First Day Complete transition is tiny. The sell-side analysts have published nothing, and their models still do not incorporate the transition. Historical numbers are virtually meaningless since they incorporate COVID school shutdowns and the non-First Day Complete model. If the company is successful in the transition, I think EBITDA should be well in excess of $125M and, because the revenue is more subscription-like in nature, it should garner a higher multiple. With revenue growth, earnings growth, and multiple expansion. It is not hard to justify a valuation several times higher than the current sub-$100M market capitalization if the transition is successful.

SHORTS

During the quarter, the Fund remained short some major indices as well as a flying taxi company, an EV charging company, a zero-revenue battery company, and an EV company that has a market capitalization in excess of $14B though it delivered fewer than 1,500 cars in the first quarter. We added a short position of an American manufacturing company that specializes in piping and is facing a significantly more intense competitive landscape.

OMAHA EVENT

I'm pleased to share that we will be hosting another event - our first "Greenhaven Road Investing Olympics" - around the Berkshire Hathaway annual meeting in Omaha. This event will be more multi-disciplinary as opposed to idea sharing. Any of our limited partners who are going to be in Omaha are invited to participate or spectate. We would love to have you. Many of you know our excellent analyst, Kyle Campbell, who is organizing the event. Get in touch with him (kyle@greenhavenroad.com) for more information.

OUTLOOK

The consensus view is that the U.S. will experience a recession. This won't be good for anybody as it will entail job losses and increased anxiety. While I have spent pages telling you how durable our portfolio is, all of the companies that we own will be negatively affected. That is the bad news. The good news is that for our larger holdings with their low churn, strong balance sheets, secular tailwinds, and positive product lifecycle dynamics, our companies should survive quite well. For our special situations, a recession may impact the multiple the CDMO business may sell for, or the multiple one may apply if the First Day Complete transition is successful at Barnes and Noble Education, but a recession should not prevent the sale or the transition. Each day that passes, we get a day closer to the day when fundamentals rule the day. Each day that passes, the companies that we own get stronger. Time is our friend, even if we have to endure a recession.

Sincerely,

Scott

APPENDIX – NEW POSITION

BURFORD CAPITAL

Burford Capital is a niche asset manager focused on litigation financing. Put simply, the company finances lawsuits in exchange for a portion of the payout if the lawsuit is successful. To be clear, I think the United States is overly litigious. Our investment in Burford is an attempt to profit from this system, not an endorsement of it. That said, Burford only profits when a claim is successful, and that dynamic incentivizes against funding frivolous lawsuits. With 158 full-time employees (including 60 lawyers on staff) and 8 offices worldwide, Burford finances commercial litigation where the case facts indicate positive expected returns on their deployed capital. (Note: They do not finance personal injury cases.)

The litigation finance model has some variations, but typically the financer (e.g., Burford) pays all the legal expenses. In the event of a loss, the financer loses their investment. If Burford's client wins the case, the financer's legal expenses are recovered first, and then the "profits" of the case are split, often 70% for the plaintiff and 30% for Burford. These splits may vary based on circumstances.

The return profile for Burford investments is asymmetric. When they lose, the losses are small. When they win, the profits can be quite large. Historically, 16% of deployments experienced losses, but when that occurred, Burford recovered 42% of deployed cost. The other 84% of deployments were profitable, with 13% generating ROICs >200%. It is likely that one case (YPF, to be discussed later) will ultimately return >100X than the amount deployed supporting the case. When historical returns are aggregated for both winners and losers, Burford's investments have on average generated returns on invested capital in excess of 90% and annualized returns of approximately 30%.

There are several contributing factors to these elevated returns. As the largest litigation financer, Burford sees the most cases and often is the only funder to see a case, as lawyers and companies are reticent to reveal case details to too many parties. As the largest player, Burford has additional capabilities such as collection/enforcement, which improve collections of judgements awarded in their favor. Burford also has the best proprietary data on legal settlements, which informs their analysis of expected case outcomes and enhances case selectivity. In 2020, Burford funded just 4% of inbound inquiries.

Litigation finance exists, in part, because law firms are not well-suited to undertake large multi-year cases on a contingency basis. Law firms are typically organized as cash partnerships with profits paid out to current partners at the end of the year. Funding a multi-year lawsuit would require today's partners to write a check out of their own pockets to fund a lawsuit which will benefit future years. As partners typically give up their equity when they leave or retire, they would be giving up the certainty of this year's profits to fund lawsuits which may or may not be successful and from which they may or may not benefit, depending on if they are still at the firm at the time of harvesting. By partnering with Burford, a firm gets paid for their work in the current year in exchange for giving up some of the potential "upside" to Burford. Law firms like the litigation finance model because they don't have to take risks and it generates business immediately.

There are also incentives for management teams to partner with Burford, even if the company has the resources to pursue a case on its own. Under GAAP accounting, legal expenses are expensed in the year incurred. Thus, pursuing a multi-year lawsuit means depressing short-term earnings in the pursuit of an uncertain future payout. Do you want to risk this year's bonus to fund a multi-year lawsuit? Even if the company is successful in winning the case, management typically does not get "credit" for the earnings as investors view the wins as one time in nature. To make this less theoretical, Sysco Corporation (NYSE: SYY), a multi-national food distribution company with a market capitalization of $37B and historically >$1.5B cash generated from operations, partnered with Burford in litigation regarding price-fixing by its suppliers. Burford was introduced to Sysco by Boies Shiller Flexner, a very prominent law firm. Burford ultimately funded $140M in legal expenses, preserving short-term earnings for Sysco and keeping Boies Shiller Flexner lawyers quite busy. The case is

atypical in that Sysco and Burford are now fighting, and that is how the funded amount has been disclosed. I don't know how the case will be resolved but cite it as an example of management choosing litigation funding even though they clearly had the resources to pursue the case on their own.

Absent a change in how law firms are structured, or management teams are compensated, the legal finance opportunity appears quite durable. Burford has the best deal flow, much of it proprietary, as well as dedicated assets to improve returns and the best data. While it is likely that future returns on deployments will be worse than historical, Burford should be able to compound their capital at high rates while supplementing their growth with third-party capital. The compounding is aided by very low taxes due to being domiciled in Guernsey.

UNDER-EARNING

COVID brought the closure of courts and a slowdown of the legal system, which in turn slowed liquidity events for Burford such as settlements and wins. As the effects of COVID dissipated, the court system has been slower in processing commercial litigation cases key to Burford's results, prioritizing criminal cases in the reopening process. While there was no material change in the "win rates" of Burford cases, near-term earnings were impacted. In effect, Burford has been under-earning because of a backlogged court system. In March, the company gave an update that indicated that there should be a dramatic step-up in activity, stating that "2023 is off to a good start, with over 30 trials or final merits hearings scheduled, almost three times as many as actually occurred in 2022." The first quarter also saw several realizations, including one case with $90M in proceeds, a verdict (which may be appealed) of $67M, and a successful appellate resolution which would produce approximately $40M in group-wide proceeds (including to Burford's non-consolidated private funds) and approximately $100M in Burford-only proceeds.

Another form of under-earning stems from Burford's asset management business and how those funds are structured. Most cases Burford funds are "on balance sheet" deployments using company capital. However, the company has also raised nine funds to manage $3.8B of outside capital. These funds use a "European Waterfall" payout structure whereby the investors recover all capital before Burford realizes fees. To date, Burford has not realized fees from these funds and thus has not reflected the economic reality historical earnings. However, as the funds mature and enter the harvesting phase, Burford will realize the fees and earnings will step higher.

Burford's earnings are quite lumpy and difficult to predict as they are impacted by the timing of case resolutions. A large win or unexpected delays can swing any quarter's earnings significantly. Predicting annual earnings with a high level of precision is virtually impossible, however, for the core litigation funding business (excluding third-party fund management), we can look at the current portfolio and historical returns to get a range of possible outcomes. In round numbers, Burford currently has ~$1.4B invested in cases at cost. Historically they have generated an ROIC of ~88% over 13 years. Normalized earnings should be north of $1.20 per share and growing.

YPF CASE

In 2012, Argentina expropriated the shares of an oil company, YPF, without compensating shareholders. Burford has been financing the lawsuits of two large former shareholders, Peterson and Eaton Park. Argentina has lost in five separate courts and even got to the U.S. Supreme Court, which refused to hear their case. On March 31, U.S. courts gave Burford another favorable ruling, stipulating many things, including that Argentina would have to pay damages in dollars instead of pesos. There are still important details to be worked out that will determine the magnitude of the win for Burford, but in round numbers, it looks like something between $10 and $25 per share (before any discounting / compromises to accelerate payments).

Given the current share price of less than $13 and the fact that the price rose less than $4 on the day of the YPF judgement, the market is heavily discounting Burford's ability to collect. Argentina has a history of slow-paying legal judgements to foreign creditors, so this is logical. You may remember that one creditor seized an Argentinian warship in their pursuit of collecting amounts due from Argentina. There are two salient points to remember that may reduce the size of the discount one should apply. The first is that, if Argentina wants to appeal the ruling at this point, it will have to post a bond or enforcement can commence. A bond will make collection simpler for Burford if the ruling is upheld. The second is that Burford has an entire collection apparatus to facilitate enforcement of court judgements. The company's CEO and Chairman each own close to $100M in stock, and Burford is by far their largest asset. As YPF is by far the largest asset within Burford, they are strongly incentivized to maximize recoveries and have had years to consider and plan for enforcement.

What is the appropriate discount to apply to YPF? Brazil's 2030 bonds currently trade at 27 cents on the dollar, or a whopping 73% discount. However, while Argentina has a long history of defaulting on its sovereign debts, it has a history of paying court-ordered debts. As Latam Advisors pointed out, "Since 2000, Argentine taxpayers have paid $17 billion in awards related to lost legal proceedings brought by defaulted bondholders and multinationals who saw their investments expropriated, their contracts terminated or illegally modified by the government. However, beneficiaries of court-ordered awards have consistently faced challenges to receive due payments as the government always puts up a good fight and delays settling with claimants." (link). Given the history of eventual payment by Argentina, the collection ability of Burford, and the fact that the any final award will accrue interest, a substantially smaller discount seems appropriate. I expect the parties will settle for a smaller than 50% discount to be paid out over several years, as it will take time for Burford to deploy the capital anyway. A 50% discount would imply $5-12.50 per share value for YPF.

VALUATION

Burford is a company that GAAP accounting is ill-equipped to deal with. Their assets are legal cases that proceed on uncertain timelines with uncertain outcomes. How do you value an interest in a legal case? When do you mark the value of a case up or down? The company is working with the SEC on this issue now and has delayed filing their financial statements as a framework is solidified. This delay, in part, created a buying opportunity (in my opinion) as the stock declined ~15% on the news.

There are three major components of Burford's valuation: the core litigation finance business, ownership of YPF claims, and a third-party asset management business. As discussed above, the YPF claims are:

> **Asset Management**: Burford has been prioritizing investing balance sheet capital over third party investments, but still raised $3.8B across nine private funds. In a March 2023 update, management estimated that the existing deployments within a portion of the managed funds should generate ~$500M in performance fees, or ~$2.30 per share. These funds also generate management fees based on the specific fund terms and investment period and should generate $15M+ in revenue per year. I believe this business line alone should be worth $4+ per share.
>
> **Litigation Finance**: The value of the core litigation finance business is highly dependent on the amount of deployments Burford makes, the ROIC of those deployments, and the average years it takes to receive recoveries from deployments. While the earnings will be lumpy, normalized earnings should be on the order of $1.20 per share and growing as the capital base grows and profits are reinvested. Applying a 10X multiple would imply the core origination business is worth approximately $12 per share.
>
> **YPF Claims**: As discussed above, there is a wide range of potential values, but applying a 50% "collection" discount implies a range of $5-$12.50 per share.

Adding the asset management business ($4) + origination business ($12) + YPF ($5-12.50) gets you a range of $21-28.50 per share, with arguably sizeable discounts applied to all three businesses. Given the current share price of approximately $13 the risk reward/remains favorable in my opinion.

A large part of investing is asking what can go wrong? In the case of Burford, laws could change that could impair their ability to finance lawsuits. However, there is another question that is not asked as often, what could go right? This is also an important question, and in the case of Burford, if Burford can continue to reinvest at high rates, they have a compounding machine – if you throw in the proceeds of a YPF into this machine and returns do not deteriorate rapidly, you can get earnings growth and multiple expansion. The upside would be substantial.

Additional Resources

The purpose of this appendix is to allow our investors to understand what we own and why we own it. For a company like Burford which is pursuing a niche opportunity and has three components to their valuation, I could have written 50 pages and still not addressed every component. Here are some additional resources on Burford if you would like to go deeper.

- Burford Company Presentation (link)
- Malcolm Brown, a private investor who has pulled together a 100-page overview of Burford (link)
  - Update based on YPF (link)
- Caro Kahn rebuttal to Muddy Waters Short Report (link)
- InPractise primary research (link) *(subscription required)*

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ROAD CAPITAL

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