# CHAIRMAN'S LETTER

Dear Shareholder,

NGE Capital Limited (**NGE** or **Company**) recorded a net profit after tax of $7.3 million for the financial year ended 31 December 2021. The portfolio returned 25.1% pre-tax and after all expenses during the year. NGE has returned, net of all expenses, 13.7% p.a. or 91.9% in aggregate since 30 November 2016, when the Company began operating as a Listed Investment Company.

The key positive contributors to portfolio performance in FY2021 were **Metals X Limited (ASX:MLX)**, **Yellow Cake plc (LSE:YCA)** and **Karoon Energy Limited (ASX:KAR)**. **Allegiance Coal Limited (ASX:AHQ)** was the only significant detractor.

In an uncertain macro environment that is currently defined by Covid-19, high and likely persistent global inflation, looming central bank rate rises, ongoing supply chain constraints, the China Producer Price Index near all-time highs, and tight labour and energy markets, amongst other extreme markers, we are increasingly focusing more of our time on event-driven special situation trades. A key characteristic of special sits is that they tend to be less correlated with the market. Examples include M&A transactions, asset sales, strategic reviews, corporate actions such as spinoffs/demergers, changes in leadership, changes in strategy, and capital management announcements such as buybacks/return of capital/increased dividends/special dividends.

In looking at more special situation opportunities, we are sticking to our investment principles:

- Target strong returns with an adequate margin of safety;
- Hold a high conviction, concentrated portfolio; and
- Invest based on fundamental analysis.

Recent examples include our investments in **Metals X**, **Jupiter Mines Limited (ASX:JMS)**, **John Wood Group (LSE:WG.)** and **Vita Group Limited (ASX:VTG)**. We discuss these companies in further detail below. We have also made investments in two new special situations this month that we may disclose in the near future once we have settled on our final portfolio weightings.

We bought a sizeable position in tin producer **Metals X** during February following the announcement of a deal to divest its problematic copper assets to acquirer Cyprium Metals Limited (ASX:CYM). The sale resulted in MLX becoming a pure play tin producer. MLX and Alphamin Resources (TSXV:AFM) are the only Western-listed pure play tin producers globally.

As at 31 December Metals X was up 194% on our average purchase price of ~19.5c, following a strong rise in the price of tin and a devaluation of the AUD against the USD. Since our initial purchase, the tin price increased ~59% to ~US$39,400/t as at 31 December and the AUDUSD FX rate decreased ~6% to ~0.725. We trimmed our position in December, and further in January and February of this year, in order to de-risk the investment, lower the portfolio weighting, and lock in some gains. We currently still hold 6.50m shares.

Tin is essential for the high-tech, low carbon economy, and is projected to be the metal most impacted by growth of new technologies such as batteries, robotics, solar power, power storage and electric vehicles. Tin prices were expected to increase as growth in tin demand outweighs new supply, leading to a significant deficit from 2025 according to the International Tin Association. Tin prices reached a record all-time high this month, as inventories have become ever scarcer. Recent price action and the forecast shortfall in supply suggest high tin prices may persist for some time to come.

At spot tin (~US$44,300) and AUDUSD FX rate (~0.7175) MLX's published mine plan would be valued at ~A$1.30. In the December quarterly the company mentioned that the mine plan has now been updated following a "robust" review of "tin price forecasts, and new development areas such as

Leatherwood along with updated metallurgical recoveries". The mention of Leatherwood references the company's recent strong near- and in-mine drilling results that have the potential to increase the mine's defined resource. Our DCF analysis ignores any potential upside from conversion of further resources to reserves, increases in the resource, and optionality provided by existing infrastructure to tie in nearby tin deposits. Whilst we have reservations about the high capex Rentails development project – tailings projects often show high NPVs but are difficult to execute – it potentially adds further upside to the investment case.

As an additional feather in MLX's cap, in January the company successfully spun out its nickel assets into **Nico Resources Limited (ASX:NC1)** via an IPO and in-specie distribution of shares to Metals X shareholders. We received our allocation of ~219k shares, which we subsequently sold at an average price of ~$0.515 per share.

**Jupiter Mines** had a board spill after an activist campaign led by substantial shareholder and legendary resources investor Hans Mende. The spill and subsequent uncertainty around the company's leadership, future strategy and capital management plans led to a significant decline in the share price that provided what we believe to be an attractive entry point. The situation is still developing, however we suspect Mr Mende will be heavily involved in drafting the company's future strategy, and focused on growing the value of his investment. At spot Mn prices we think Jupiter is worth ~30c per share. At a Mn benchmark price of US$4/dmtu (prices have traded well north of this level for extended periods), we value Jupiter at ~45c per share.

**Wood Group**, a provider of consulting, project management and asset optimisation services to the energy sector (with a heavy weighting to conventional oil & gas), announced a strategic review of its Built Environment consulting business in November 2021. The stated purpose was to assess "a range of options to best unlock value from this part of the business for shareholders that Wood believes is not currently being recognised in its market capitalisation".

BE is the jewel in Wood's crown, a high margin business that has been growing strongly as demand for sustainable infrastructure increases. We think a sale of BE could generate net after-tax proceeds of ~US$1.6-2.1bn against Wood's EV of ~US$3.5bn, and would solve the company's high leverage and leave the company in a net cash position. The remaining oil & gas focused operations are probably not of the quality of Worley Limited (ASX:WOR), which trades at a FY22E EV/EBITDA of ~9.8x. However, it would not be unthinkable to see a re-rating to 6-8x EV/EBITDA, which would imply a share price of ~GBP2.85-3.75 even at the low end of our estimated sale price for BE. We picked up 153k shares at ~GBP1.87 in December, before the share price ran up. We added to our position this month after the share price fell back towards our entry price on news of a $100m impairment to a legacy contract and a delay in the publication of the company's FY21 results.

We invested in **Vita Group** following a sharp share price decline caused by the announcement that Telstra intended to transition to full corporate ownership of its Telstra-branded retail stores across Australia, including 104 stores operated by Vita Group. We thought that there was a good chance that VTG would be able to do a deal with Telstra in the 12 months following our purchase that would have left VTG with net cash proceeds – after our estimate of tax and restructuring costs and including cash already on balance sheet – of $1.10+. We expected that VTG would return capital to shareholders at a level that at least covered our purchase price of ~82c, leaving us with a free option on the roll-out of the promising Artisan Skin Health and Wellness clinic network. We hadn't banked on Telstra paying VTG less for what is perhaps the best-run Telstra retail franchise operation, compared to what Telstra had been paying individual and small franchises. As a result, the sale ended up being well below our expectations. However, despite the thesis not quite working out, we were still able to exit our position for a small overall profit.

We think the above examples show that if we pick our targets carefully, event-driven special situations should provide an attractive and asymmetric risk-reward. We discuss certain other portfolio investments below.

Uranium found favour with investors during the year, and a big reason for the enthusiasm was the frenzied spot buying action of $U_3O_8$ by **Sprott Physical Uranium Trust (TSX:U.UN)**. SPUT is the trust entity that emerged after Sprott Asset Management agreed to take over management of one of our portfolio holdings, **Uranium Participation Corp**, after it was converted from a corporation to a trust. We received SPUT units as part of the transaction. We welcomed the renewed attention on the uranium industry, as we were admittedly early on our call, having initiated our position in physical uranium holding fund Yellow Cake plc in July 2018.

SPUT has taken a very aggressive approach to accumulating physical uranium, funding its purchases by selling new units on-market via an "At-The-Market" (ATM) facility. The ATM facility has grown in size from an initial US$300m to US$3.5bn. The trust issues new units when they are trading at a premium to NAV, so even though its purchases have driven up the price of $U_3O_8$, they have still been accretive to existing unitholders. Since the conversion from UPC in June to present, SPUT has grown its holdings of $U_3O_8$ equivalent from ~19.1mmlbs to ~45.9mmlbs. Its NAV has grown from ~US$600m to ~US$2.0bn over the same period. It was perhaps no surprise that 2021 saw the highest volume of spot market trades in history at 102mmlbs of $U_3O_8$ equivalent. The $U_3O_8$ price rose from US$30/lb to US$42/lb over the year, an increase of 40%.

During October we switched out of a portion of our holding in Yellow Cake and into more units of SPUT whilst YCA was trading at a ~7% premium to NAV and SPUT traded at close to par. Net of transaction costs and slight timing differences, we gained a ~5% benefit in overall NAV. We may carry out further such trades in the future when the opportunity presents, as we think it makes sense to have a higher weighting in the larger and more liquid SPUT vehicle.

Perhaps the biggest positive change to the uranium thesis during 2021 was a perceived softening in societal attitudes towards nuclear power, as people start to accept that nuclear power will likely play a bigger role in the global energy mix as countries push towards net-zero carbon emissions targets. The European Commission this month approved in principle to declare nuclear energy as sustainable as part of the EU's efforts to become climate neutral by 2050. The "Taxonomy classification" aims "to guide private investment to activities that are needed to achieve climate neutrality" (translation: encourage investment in European nuclear power).

Global demand for uranium is ~175mmlbs of $U_3O_8$ equivalent, versus ~125mmlbs of global primary production currently. The ~50mmlbs shortfall is made up by secondary sources, which includes perhaps ~15-25mmlbs of supply from uranium conversion facilities and the remainder from drawdowns of above-ground inventories. Under most base case forecasts, demand is expected to grow to ~200mmlbs of $U_3O_8$ equivalent by 2030. Should the renewed interest in nuclear power translate into new reactors, demand should grow beyond base case forecasts even if the reactors are not yet built by then – any utility building a new reactor will want to ensure a source of supply well before the plant is commissioned. That would result in an even greater primary supply deficit, and an expected faster drawdown of inventories. The big unknown that we have previously highlighted is the level of inventories that always seem to be higher than the market thinks.

During the year we acquired 2.35m shares of **Evolve Education Group (ASX:EVO)** at an average price of ~A$0.70 per share. We settled on our initial holding size as the stock is illiquid. Evolve is a provider of Early Childhood Education (ECE), operating 111 childcare centres in New Zealand and 23 in Australia. We think the shares have been oversold, despite investors' well-founded concerns around the historical and continuing underperformance of the NZ centres, and a current dearth of ECE qualified teachers in NZ (which in addition to staff shortages is leading to wage pressures).

Assuming New Zealand eases its enthusiasm for lockdowns, Evolve trades at ~5.5x EV/FY22E EBITDA, hardly a demanding valuation when compared to recent comparable transactions done at ~9-10x. The main catalyst to a re-rating would be a sale of Evolve's NZ operations, which would provide valuable capital to grow the Australian business, the more attractive part of Evolve. Australian centres are doing ~30% EBITDA margins at 86% occupancy versus the NZ centres doing ~9.8% margins at 69% occupancy.

Based on the company's December trading update, Evolve's 23 Australian centres are each doing ~A$750k EBITDA p.a. on average. Valuing each centre at 4x EV/EBITDA yields ~A$3m per centre, or ~A$70m for the Australian centres. Deducting Australian corporate overhead of ~A$1-1.5m at the same 4x multiple yields a net valuation of ~A$65m. At Evolve's current EV of ~A$105m (assumes net cash of ~A$20m as at 31 December), the NZ operations are being valued at ~A$40m (~NZ$43m) or ~NZ$390k per centre.

In October UK-based Busy Bees paid NZ$160m for NZ-based childcare operator Provincial's 75 centres, or ~NZ$2.1 million per centre. Provincial's centres reportedly do ~NZ$17.5m EBITDA in aggregate. Applying the same implied transaction multiple of ~9.1x to Evolve's NZ centres gives a valuation of ~NZ$100m.

We don't need much to go right for the thesis to play out in our favour. A sale of the NZ operations for somewhere between NZ$40m and NZ$100m would be enough to remove the valuation handbrake and allow MD Chris Scott to accelerate his Australian growth plans. The market would likely reward a sensible, profitable growth story with an attractive valuation re-rating.

Our investment in **Allegiance Coal Limited (ASX:AHQ)** has so far been disappointing, with the share price down 30% from our average purchase price of ~70c. The performance and struggles of the company since our investment highlight the risks of investing in start-up operations of any kind, whether a pre-profit tech company or a mothballed coal mine in Colorado.

We were perhaps unlucky in our timing, preceding the opportunistic acquisition of the Black Warrior Mine funded via a A$30m equity raise at 67c. However, the A$30m placement shortly thereafter at 50c to acquire the unpermitted Short Creek development project decimated the share price and had us scratching our heads as to the merits and timing of the transaction.

The company appears to be getting on top of the issues that have hampered ramp-up of the New Elk mine, and the Black Warrior Mine looks like it may prove to be an astute purchase. However the company's working capital situation is a concern, and we suspect that the company may need to raise further equity to provide a bridge to run-rate production and commensurate sales at benchmark prices. During the December quarter the company mentioned it had borrowed US$8.9m, repayable by paying US$11.48m in May 2022. We calculate that the effective yield to maturity is ~66% for the debt provider, which is getting up towards loan-shark rates. Cash will likely be tight for Allegiance for the next few quarters.

We haven't yet lost faith in the story, but the company will need to put together consistent production whilst benchmark High Vol A and High Vol B prices remain elevated. If they can do so, the company will likely re-rate to multiples of the current share price.

NGE remains a simple, clean and tax efficient investment vehicle, with ~$42 million of Australian unused and unrealised losses available at year end. In the aggregate these losses equate to a potential future tax benefit of ~$10.5m or ~$0.29 per share (of which only ~$2.3m or $0.064 per share is recognised in our after tax NTA). The Company has received tax advice that these losses are available to be offset against future tax liabilities so long as NGE continues to satisfy the continuity of ownership test as set out in Divisions 165 and 166 of the Income Tax Assessment Act 1997 (Cth).

Whilst we performed well in 2021, we are conscious that we left plenty of money on the table. We intend to capitalise further on our strengths in 2022 by applying patience, discipline, conviction and opportunism to produce strong risk-adjusted returns over the medium to long term.

Yours sincerely,

**David Lamm**
Executive Chairman
& Chief Investment Officer

**Adam Saunders**
Executive Director
& Portfolio Manager

25 February 2022

**IMPORTANT INFORMATION:**
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