

Investment & NTA Update

30 April 2022



NGE Capital Summary

ASX ticker	NGE
Share price (30 Apr 22)	\$0.890
Shares outstanding	36,000,000
Market cap	\$32.0m
NTA per share before tax	\$1.087
NTA per share after tax	\$1.152
NTA before tax	\$39.1m
NTA after tax	\$41.5m

Overview

NGE Capital Limited is an internally managed Listed Investment Company which allows investors to gain exposure to a concentrated, high conviction, actively managed portfolio of financial assets. NGE primarily focuses on listed ASX and international equities, with the aim of generating strong risk-adjusted returns over the medium to long term.

Board & Management

David Lamm Executive Chairman & Chief Investment Officer	Adam Saunders Executive Director & Portfolio Manager
Ilan Rimer Non-Executive Director	Les Smith Company Secretary & Chief Financial Officer

Contact Details

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Net Tangible Assets Per Share

	30 Apr 2022	31 Mar 2022
NTA per share before tax	\$1.087	\$1.048
NTA per share after tax	\$1.152	\$1.113

NTA Per Share Performance Summary

1 month	Year-to -date	Last 12 months	Since inception ¹ (p.a.)	(cum.)
3.7%	11.1%	28.9%	15.0%	113.2%

Note: Returns are net of all expenses.
1 From 30 Nov 2016, the date on which NGE became a LIC.

Portfolio Composition

Company	Ticker	% of NTA
Yellow Cake plc	LSE:YCA	16.5%
Metals X	ASX:MLX	12.3%
John Wood Group plc	LSE:WG.	10.1%
Capricorn Energy plc	LSE:CNE	7.4%
Jupiter Mines	ASX:JMS	5.6%
Evolve Education Group	ASX:EVO	5.3%
Embecta Corp.	NAS:EMBC	5.0%
Sprott Physical Uranium Trust	TSX:U.UN	4.8%
Allegiance Coal	ASX:AHQ	4.4%
International Petroleum	TSX,STO:IPCO	3.2%
Undisclosed	Listed	2.6%
Medusa Mining	ASX:MML	2.1%
Austin Engineering	ASX:ANG	1.7%
Consortio ARA	MEX:ARA	0.8%
Net cash and other		18%
Total		100%

Unrecognised Tax Losses

The Company has ~\$38 million of Australian unused and unrealised losses available as at 30 April 2022. In the aggregate these losses equate to a potential future tax benefit of ~\$9.5m or ~\$0.27 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).

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Commentary

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During April we made the following portfolio changes:

- We increased our holding in **John Wood Group plc (LSE:WG.)**, and currently hold 1.0m shares acquired at an average price per share of ~GBP1.67.
- We increased our holding in **Capricorn Energy plc (LSE:CNE)**, and currently hold 798k shares acquired an average price per share of ~GBP2.09.
- We initiated a new position in **Embecta Corp. (NAS:EMBC)**, acquiring 45.5k shares at an average price per share of ~US\$28.80. We lay out our investment thesis below.
- We initiated a new position in another developing special situation (market cap >US\$1bn) that we may disclose once we have settled on an appropriate portfolio weighting.
- We exited our position in **Geo Energy Resources (SGX:RE4)**, selling out at an average price per share of ~S\$0.562 (including dividends to be received on 10 May). We made a ~A\$935k overall profit from our investment in Geo Energy, or a ~28% return on our initial position taken in October, though we had trimmed our holding significantly since then in order to de-risk the investment. We may revisit the thesis if the share price falls sufficiently below our estimate of intrinsic value.
- We exited our position in **Humm Group (ASX:HUM)** for a small loss, after re-evaluating the position and concluding that the risk-reward setup is not sufficiently attractive to maintain the position currently. We may reconsider the opportunity in the future, as there is still some time before the proposed transaction with **Latitude Group Holdings (ASX:LFS)** is due to close.
- We exited our position in **Base Resources (ASX:BSE)**. Over our hold period we made a ~48% return on investment, including dividends received, for an aggregate net profit of ~\$969k. As we noted in our NTA Statement as at 31 October 2021, we may decide to reinvest in the future if some of the uncertainties around extending Kwale's mine life and finalising fiscal terms for the Toliara project are resolved.

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Embecta Corp. is a diabetes care business that was spun-off on 1 April via an in-specie distribution to shareholders of **Becton, Dickinson and Company (NYS:BDX)**, with shareholders receiving 1 Embecta share for every 5 BDX shares held.

Embecta cap structure		
Share price (30-Apr-22)	\$	\$30.43
Shares out.	m	57.0
Market cap	\$m	1,733
5.000% Senior Secured Notes (Feb-30)	\$m	500
6.750% Senior Secured Notes (Feb-30)	\$m	200
Term Loan B (Mar-28)	\$m	950
Revolver (5 yr)	\$m	0
Total loans and credit facilities	\$m	1,650
Cash	\$m	160
Receivables factoring agreement adj	\$m	101
Pro forma cash	\$m	261
Pro forma net debt	\$m	1,389
EV	\$m	3,122

Embecta is the number one producer globally of diabetes injection devices, with a long history of innovation and product improvement. The company has historically been a low growth, high margin cash cow.

HISTORICAL CASH FLOWS

(US\$m; FYE 30 September)

		2019A	2020A	2021A
Operating cash flow	\$m	505	499	456
Investing cash flow	\$m	-69	-42	-39
Financing cash flow	\$m	-436	-457	-417

Source: Embecta Information Statement, 10 Feb 2022.

Note: Financing cash flows represent dividends paid to BDX parent.

Nevertheless, its earnings contribution is immaterial within the context of ~US\$70bn market cap behemoth BDX's diversified portfolio of medical devices, instrument systems, and reagents.

The relative size difference between the parent company and SpinCo attracted us to this opportunity as we believed Embecta would be the subject of uneconomic selling: BDX is in the S&P 500 index whilst Embecta has been "demoted" to the S&P SmallCap 600 index. There was indeed heavy selling once trading in EMBC began as BDX shareholders, including S&P 500-focused ETFs, dumped shares. This allowed us to purchase our holding at what we believe to be an attractive price.

The company manufactures and sells insulin syringes, pen needles, and other products related to the injection or infusion of insulin and other drugs in the treatment and management of diabetes. Embecta produces over 7.6bn units annually from three manufacturing facilities in Ireland, the US and China. The company estimates its products serve 30m patients in over 100 countries worldwide.

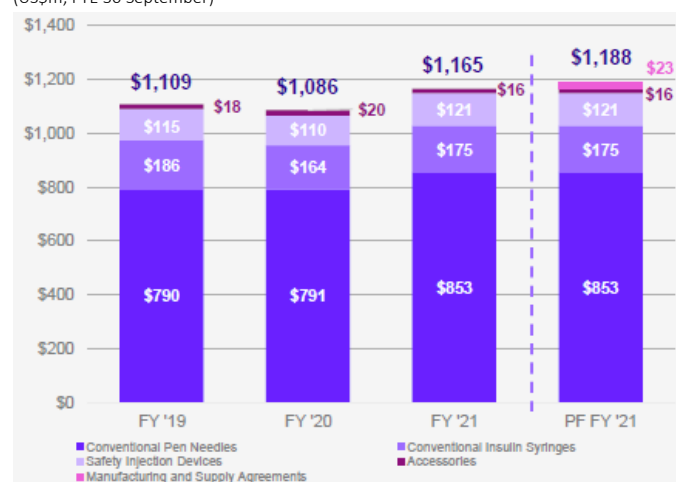
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HISTORICAL REVENUE – BY PRODUCT

(US\$m; FYE 30 September)



Source: Embecta investor presentation, 7 March 2022

Diabetes is a chronic condition for which there is no known cure, and is caused either when the pancreas produces insufficient insulin (Type 1 diabetes) or when the body cannot efficiently use insulin (Type 2 diabetes). Insulin is a hormone produced by the pancreas that regulates the amount of glucose in the bloodstream. It also helps store excess glucose in the liver. People with Type 1 diabetes need to take insulin to survive. People with Type 2 diabetes can avoid insulin use by exercising, losing weight, eating healthier, or using other prescription medicines. Approximately 90% of diabetes cases are Type 2.

According to the International Diabetes Federation, approximately 537m adults (aged 20-79) worldwide were living with diabetes in 2021, including those who are not yet diagnosed, and the number is projected to increase to 643m adults by 2030 and 783m adults by 2045. Insulin therapy is the most common approach to diabetes management.

Embecta estimates that approximately 90-120m people require insulin therapy, and that 95% of those who are undergoing insulin therapy administer insulin through injection. Another increasingly common way to administer insulin is via continuous subcutaneous insulin infusion, administered through an insulin pump. Wealthier countries are seeing higher adoption rates of insulin pumps, whilst injection is expected to remain the standard of care for developing countries.

Embecta estimates that the total addressable market for insulin administration devices is approximately \$6bn to \$8bn per year, based on the number of insulin-dependent individuals worldwide.

Embecta distributes its products via wholesale channels, retail pharmacies, long-term acute care hospitals and individual practitioners. McKesson Corporation, Cardinal Health and AmerisourceBergen Drug Corporation are Embecta's largest distributors, and account for ~39% sales. Sales to five of the largest retail pharmacy chains account for ~14% of sales. Embecta offers rebates in the order of ~17-20% of revenues.

SUMMARY P&L

(US\$m; FYE 30 September)

		2019A	2020A	2021A	PF			
					2021	2022E	2023E	2024E
Revenue	\$m	1,109	1,086	1,165	1,188	1,188	1,200	1,212
Growth	%		-2.1%	7.3%	9.4%	0.0%	1.0%	1.0%
Gross Profit	\$m	786	763	800	778	756	742	727
Margin	%	70.9%	70.3%	68.7%	65.5%	63.7%	61.8%	60.0%
EBITDA ⁽¹⁾	\$m	536	524	533	475	384	416	392
Margin	%	48.3%	48.3%	45.8%	40.0%	32.4%	34.7%	32.3%
EBIT	\$m	500	486	495	438	347	379	355
Margin	%	45.1%	44.8%	42.5%	36.9%	29.2%	31.6%	29.3%
NPAT	\$m	432	428	415	306	228	256	235
NPAT adj ⁽²⁾	\$m	432	428	415	306	276	256	235
EPS adj ⁽²⁾	\$	\$7.59	\$7.51	\$7.29	\$5.37	\$4.84	\$4.49	\$4.12

Source: Embecta filings, NGE forecasts.

- (1) 2022E EBITDA includes one-off distribution expense of \$56m.
- (2) Adjusted for \$56m one-off expenses.

Company management is guiding to "relatively flat" revenue growth through 2024, with modest growth coming from emerging markets which it defines as Eastern Europe, the Middle East, Africa, Latin America, Central and Southeast Asia and Mainland China.

Management has also guided to lower gross margins, trending to ~60%, mainly due to the two-way manufacturing and supply agreements entered into with BDx. R&D is expected to rise to ~7% of sales, up from ~5% currently, as the company develops new products including an insulin pump ("patch pump") targeting unmet needs for people with Type 2 diabetes.

One-off expenses of ~\$56m are expected to be incurred within 12 months of the spinoff, as well as an estimated \$33m of recurring expenses as a standalone public company. The net effect is that management has guided to ~30% EBITDA margins by year three post-spin, quite a haircut compared to pre-spin margins. We got the sense that management is being conservative on guidance. We think the stock-based compensation structure for management is sensible enough, and does not appear to provide an incentive to sandbag numbers in order to "get set" before walking back guidance. We therefore wonder if management is trying to manage

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expectations in order to build credibility.

As part of the spin, Embecta paid BDX a cash dividend of ~\$1,440m. The dividend was funded by distributing any cash on its balance sheet in excess of \$160m and the issuance of \$500m of 5.000% Senior Secured Notes due Feb-30, \$200m of 6.750% Senior Secured Notes due Feb-30, and a \$950m Term Loan B (SOFR + 3.000%, with SOFR floor of 0.50%) with 7-year maturity. EMBC also factored its receivables for ~\$101m cash via BDX for a nominal fee, leaving the company with ~\$261m of pro forma cash. The debt will add ~\$79m of interest expense (cash interest of ~\$72m and amortisation of debt issuance costs of ~\$7m), and put leverage at ~3.5x.

Embecta benefits from low foreign income tax rates that reduce its effective tax rate by ~6-8% (from the US corporate rate of 21%). It appears to achieve this by booking the majority of its pre-tax profits in Ireland (~80-85%).

The company is targeting a dividend payout ratio of ~20% of GAAP net income, with plenty of scope to increase the dividend to a more meaningful amount in the future.

VALUATION

		Low	High
FY24E NPAT	\$m	220	250
P/E multiple	x	10	14
Implied market cap	\$m	2,200	3,500
Shares outstanding	m	57.0	57.0
Share price	\$	39	61
Upside	%	27%	102%

It is hard to find a good comparable listed company given EMBC has a very narrow product line, though similar manufacturers of simple, low complexity, high volume medical devices trade at P/E ratios of 20x+. That is clearly too high for a low growth business like EMBC. Additionally, its competitors such as **Novo Nordisk (NYS:NVO)**, **Terumo (TKS:4543)** and **Ypsomed (SWX:YPSN)** are either too large and diversified, or in the case of Ypsomed barely profitable.

However, we think **Societe BIC SA (PAR:BB)**, the manufacturer of ball point pens, lighters and razors, might be a reasonable comparable. BIC sells similar complexity products, has low sales growth (excluding impact of Covid-19), similar gross margins (~50%), and EBITDA margins of ~20%. It trades at a FY22E P/E of 11.5x.

We reckon Embecta is potentially worth 10-14x P/E (FY24E), or ~\$39-61 per share which implies ~27-102% upside to the month-end share price of \$30.43. We believe this is defensible based on its dominant market position, strong cash flow generation, and ability to grow in the medium-to-long term via organic commercial initiatives, development and commercialisation of new products such as the patch pump, and M&A and partnerships. Indeed, partnerships are prevalent in the diabetes care industry, with pharma companies that make insulin partnering with pump makers, glucose sensor specialists and software developers that can link these systems. Embecta was hampered from pursuing such partnerships as a subsidiary of BDX.

RISKS

- Any new innovation that would decrease need for daily insulin shots.
- Any change to the reimbursement regime by private and government payors.
- Embecta will be required to rebrand its products to remove the “BD” name, which could adversely affect its ability to attract and maintain end users.
- BDX can cancel its cannula supply agreement on 36 months’ notice, but not earlier than 10 years from the distribution date of 1 April 2022.
- Under a change of control of EMBC, BD can cancel its cannula supply agreement (may ward off potential suitors).
- Three distributors account for 39% of EMBC’s sales – BDX will likely have more price setting power than EMBC when negotiating supply agreements, which could erode margins (perhaps they are factoring this in already with their GM downward guidance).
- Competition between EMBC and its competitors for favourable placement in “formulary inclusions” that specify coverage under healthcare plans is putting pressure on prices “particularly in treatment areas in which the payer has taken the position that multiple branded products are therapeutically comparable (like that of diabetes). These downward pricing pressures could continue to negatively affect Embecta’s business”.



Announcement released to the market with the authorisation of:

David Lamm
Chief Investment Officer

Adam Saunders
Portfolio Manager