

NGE CAPITAL LIMITED SUMMARY

ASX ticker	NGE
Share price (31-Jan-19)	\$0.675
Shares outstanding	37,194,774
Market cap	\$25.1m
NTA per share before tax	\$0.830
NTA per share after tax	\$0.866
NTA before tax	\$30.9m
NTA after tax	\$32.2m

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.

INVESTMENT STRATEGY

NGE has a flexible investment mandate and invests according to a defined set of investment principles, summarised as follows:

- Only invest in a compelling opportunity, otherwise hold cash;
- Invest based on fundamental analysis;
- Target investments that can generate strong returns with an adequate margin of safety; and
- Aim to hold a concentrated portfolio of high conviction investments.

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 (NTA) PER SHARE

	31 Jan 2019	31 Dec 2018
NTA per share before tax	\$0.830	\$0.765
NTA per share after tax	\$0.866	\$0.819

NTA PER SHARE PERFORMANCE SUMMARY

1 month	Year-to-date	Last 12 months	Since inception ⁽¹⁾	
			(p.a.)	(cum.)
8.5%	8.5%	26.1%	25.2%	62.7%

Note: Returns are before tax and net of all operating expenses. As an internally managed LIC NGE does not incur external management and performance fees.

(1) From 30 November 2016, the date on which NGE became a LIC.

TOP HOLDINGS (% OF NTA)

Company	Ticker	%
United Company RUSAL	HKE:0486	21.8%
Powerwrap	Unlisted	19.3%
Yellow Cake plc	LSE:YCA	14.8%
Eureka Group	ASX:EGH	8.3%
Horizon Oil	ASX:HZN	8.1%
Warrior Met Coal	NYS:HCC	6.0%
Base Resources	ASX:BSE	5.7%

PORTFOLIO COMPOSITION

	31 Jan 2019
Listed equities	72%
Unlisted equities	20%
Convertible notes	3%
Cash less other net assets	5%
Total	100%

UNRECOGNISED TAX LOSSES

The Company has ~\$22 million of realised and unrealised income tax losses and ~\$20m of capital losses available as at 31 January 2019. In the aggregate these losses equate to a potential future tax benefit of ~\$11.5m or ~\$0.31 per share (of which only a small portion is recognised in our after tax NTA). The Company has received tax advice that these losses should be 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).

MONTHLY COMMENTARY

NGE's portfolio produced a return of 8.5% for the month of January. On a rolling 12-month basis, the portfolio is up 26.1%.

On 28 January the US Department of Treasury's Office of Foreign Assets Control (OFAC) removed the sanctions imposed on **United Company RUSAL Plc (HKE:0486)**, following through on its 19 December announcement. RUSAL's share price has risen strongly as a result, closing at HK\$3.28 by month-end, however remains a long way off its pre-sanctions trading level. Even at a share price of HK\$4.64 prior to the sanctions RUSAL looked cheap back then, trading on an EV/FY18E EBITDA multiple (adjusted for Nornickel) of ~3.7x versus Alcoa at ~4.2x, aluminium peers at ~6.8x, and global diversified miners at ~5.3x. NGE averaged invested at around half that price averaging in initially at ~HK\$2.26. We increased our stake slightly in December at ~HK\$2.60.

We initially dipped our toe with a small investment in **Warrior Met Coal Inc (NYS:HCC)** in November 2017, and probably underinvested at that time. Recent volatility has afforded us an attractive entry point for further investment in November and December 2018 at a share price of ~US\$22.80.

Warrior is a NYSE-listed producer and exporter of metallurgical coal from two underground mines located in Alabama. The company also has 103m short tons of undeveloped reserves at the Company's Blue Creek Energy Mine. Met coal is used to produce coke, which is an essential fuel and reactant in the blast furnace process for the manufacture of steel.

The Company has operational capacity to mine ~8 million St (~7.25 million metric tons) of met coal per year from recoverable reserves of ~101m St. Warrior's coal contains low sulfur and has strong coking properties and therefore receives a slim discount (~2%) to the globally recognised Hard Coking Coal benchmark set in Australia, which is used to set quarterly pricing for the met coal industry.

Warrior is a simple, pure-play met coal business that is highly cash generative. We like the business because its mine infrastructure is already built, the mine has been in production for a number of years, and the company is focused on returning cash to shareholders. This has been evidenced by the **payment of US\$17.94 in gross dividends since we purchased our initial stake at US\$27.50 in November 2017.**

The high spot coal price (~US\$200/t) means Warrior is absolutely creaming cash flows, with EBITDA of ~US\$635m and FCF of ~US\$495m. On a P/E basis this equates to 3.0x, which is dirt cheap. Of course the coal price is expected to decrease, but even at US\$160/t the value still makes sense to us.

SUMMARY CAP TABLE

Ticker		NYS:HCC
Price (31 Jan 2019)	US\$	28.73
Market cap	US\$m	1,516
EV ⁽¹⁾	US\$m	1,743
EV / EBITDA (FY19E) ⁽²⁾	x	4.3
P / E (FY19E) ⁽²⁾	x	5.7
NGE position size	%	6.0%

(1) EV based on NGE internal estimate of net debt as at 31 December 2018.

(2) Based on assumed FY19E met coal price of US\$165/t (vs spot price ~US\$200/t).

Assuming a FY19E coal price of US\$165/t (which looks very conservative against current spot), and a long-term (2020E+) price of US\$160/t, we value Warrior's operations at ~US\$34 per share (net of net debt and asset retirement obligations). The Blue Creek Mine could be worth an additional ~US\$1 per share.

IMPORTANT INFORMATION:

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SUM-OF-THE-PARTS VALUATION

	Valuation US\$m	Per share US\$
DCF - operating mines (10% WACC) ⁽¹⁾	\$2,097	\$39.74
Blue Creek (undeveloped) ⁽²⁾	\$52	\$0.98
Net debt as at 31 Dec 2018 (estimate)	-\$227	-\$4.30
Asset retirement obligations	-\$98	-\$1.86
Total equity valuation	\$1,823	\$34.55
Upside		20%

(1) Assumes FY19E coal price US\$165/t; LT US\$160/t.

(2) Assume US\$0.50/St on 103m St of reserves.

We estimate that the company will have ~US\$240m of cash at year end (~US\$4.50 per share), part of which could be paid out as another special dividend of perhaps US\$2-3. Against the month-end price of US\$28.73, that would represent a 7-10% dividend yield.

Worth noting here is the large short interest in Warrior. Short interest started building in November 2017 and has persisted ever since. Short interest was 8.65m shares as at 31 December 2018, out of a total of 52.76m shares, which means roughly 1 in every 6 shares is short.

The persistent short interest is probably down to a few factors:

- Expected sell-downs by private equity funds – hedge funds can close out shorts at a discount to market. The PE funds that acquired Warrior out of bankruptcy currently hold ~14.4m shares (27.3%), having sold down ~15.2m shares since IPO;
- Expectations that the high coal price cannot last, and therefore the share price has reached peak value; and
- The CEO has sold around half his holding since March.

If the cost to short is relatively low ($\leq 3\%$ p.a.), then it makes a lot of sense for a hedge fund to sell at or near what they perceive to be the top of coal prices. However, it is unlikely that shorters expected coal prices to increase and actually persist at higher prices: Warrior's average sale price was ~US\$185/t in 4Q17 when the shorts first appeared, but should be closer to US\$215/t for 4Q18. We do not believe now is the time to exit this successful investment so far, however we are conscious of the very significant counter position to our long.