NGE Capital Limited

Investment and NTA update | As at 31 July 2018

NGE CAPITAL LIMITED SUMMARY

ASX ticker	NGE
Share price (31-Jul-18)	$0.68
Shares outstanding	37,323,672
Market cap	$25.4m
NTA per share after tax	$0.810
NTA	$30.2m

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 July 2018	30 June 2018
NTA per share before tax	$0.810	$0.793
Expected tax liability on realised and unrealised income and gains	($0.050)	($0.045)
Previously unrecognised tax losses now brought to account to reduce tax expense	$0.050	$0.045
NTA per share after tax	$0.810	$0.793

NTA PER SHARE PERFORMANCE SUMMARY

			Since inception (1)	
1 month	Year-to-date	Last 12 months	(p.a.)	(cum.)
2.1%	28.6%	30.9%	32.0%	58.8%

Note: Returns are net of all operating expenses and expected taxes. 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 an LIC.

TOP HOLDINGS (% OF NTA)

Company	Ticker	%
Powerwrap	Unlisted	19.7%
United Company RUSAL	0486.HKE	14.1%
Eureka Group	ASX:EGH	8.2%
Base Resources	ASX:BSE	7.0%
Not disclosed	Listed	4.6%
Millennium Services	ASX:MIL	3.3%

PORTFOLIO COMPOSITION

	31 July 2018
Listed equities	39%
Unlisted equities	20%
Convertible notes	3%
Cash less other net assets	38%
Total	**100%**

UNRECOGNISED TAX LOSSES

After providing for the expected tax liability on year-to-date realised and unrealised income and gains NGE has approximately $21m of realised tax losses that are not currently carried on the Company's balance sheet as a deferred tax asset. In addition, NGE also has approximately $21m of capital losses available as at 31 July 2018.

The Company has received tax advice that these losses should be available to be offset against future tax liabilities, which in the aggregate equates to a potential future tax benefit of approximately $12m or $0.31 per share, 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 2.1% for the month of July. On a rolling 12-month basis, the portfolio is up 30.9%.

During the month the Company accepted ERAMET's takeover offer for **Mineral Deposits Limited (ASX:MDL)** of A$1.75 cash per share. NGE made a $10.6m profit on a $3.3m investment for a total return of 318% over 20 months. In our minds ERAMET is no doubt getting a good deal, but we felt on balance that a guaranteed lower cash offer won out versus an at-risk $2-3 per share valuation (depending on commodity price and production assumptions). We are certainly not disappointed with the outcome overall.

We exited our investment in **Godfreys Group Limited (ASX:GFY)** in June after it was put out of its listed misery, taken public-to-private for a second time by John Johnson. Unfortunately for us, the takeout price of 33.5c was a big haircut to our initial investment. When we invested, Godfreys was profitable, cashflow positive and traded on very low EV/EBITDA and P/E multiples, making it one of the cheapest stocks on the

ASX. We were aware that it is in a tough sector and had been going through some management and strategy changes as well. At the time we invested all our research and due diligence led us to believe that the company was in the early stages of turning around and improving operational performance, however we were clearly mistaken and for that we apologise to our investors. In the end the company was not able to improve its operating performance, and competition from the likes of Harvey Norman, JB Hi-Fi and even Aldi made the going increasingly tough.

Following the initial takeover offer from Mr Johnson we materially increased our stake at 30c and subsequently managed to extract a slightly higher offer than the original 32c price, capturing a further 1.5c per share for a small additional profit. Nonetheless overall Godfreys was a very poor investment for us. We will no doubt make other errors of judgement in the future, and of course we will also own up to them and seek to learn from our mistakes. However, making mistakes can still be part of a winning investment formula, as we wrote in the 2017 Annual Report:

> *[I]f we make six or seven investments and one goes very wrong we can still generate strong returns from the portfolio. This year was a great example of that: we made a big loss on our investment in Godfreys, but our portfolio still generated a very strong return for the year.*
>
> *Mathematically we can only lose 100% of any single mistaken investment, but we can make multiples of our capital on a great investment, so we focus on picking likely winners and can live with the occasional error or unforeseen event.*

Following the exits from our investments in Mineral Deposits and Godfreys, NGE has a significant cash balance to deploy into future investments. However we want to remind our investors of our first investment principle:

> *Only invest in a compelling opportunity, otherwise hold cash.*

So whilst we are constantly on the lookout for compelling investments, we will not rush to deploy capital for the sake of it. So far we have made new investments into three companies: Base Resources and United Company RUSAL, which we comment on below, and a position in another listed company which we have begun building and we will disclose in the future.

We still view the mineral sands industry favourably, with the outlook for mineral sands prices and zircon in particular remaining strong. We recently made an investment in **Base Resources Limited (ASX:BSE)**, which has significant exposure to zircon, ilmenite and rutile through its Kwale Mineral Sands Project in Kenya. Base also recently purchased the high quality Toliara development project in Madagascar. The early stage nature of Toliara makes this a slightly unusual investment for us, however Base appears to be significantly undervalued when summing the value of the remaining life of Kwale with a risked valuation for Toliara.

We have also recently built a position in **United Company RUSAL Plc (0486.HKE)**, a Hong Kong- and Moscow-listed vertically integrated aluminium producer, responsible for around 6% of global aluminium production. RUSAL operates 12 aluminium smelters (4mtpa capacity), 10 alumina refineries (10.5mtpa capacity) and 8 bauxite mines (17.5mtpa capacity). RUSAL is favourably positioned in the first quartile of the global cost curve, helped by its core smelting operations being located close to Siberian hydro power plants and therefore having access to cheap electricity supply.

RUSAL also has a strategic 27.8% stake in listed MMC Norilsk Nickel PJSC (Nornickel) which makes up ~60% of RUSAL's enterprise value. Nornickel is a leading nickel producer and no. 1 palladium producer globally, as well as a significant producer of platinum and copper. Nornickel produces battery-grade refined nickel that is suitable for use in electrical vehicles. Development of the EV industry should underpin long-term demand for Nornickel's core commodity.

We invested following a dramatic share price fall after the US Department of Treasury's Office of Foreign Assets Control (OFAC) slapped sanctions on several Russian oligarchs and companies, including RUSAL, its major shareholder En+, and En+'s major shareholder Oleg Deripaska. Mr Deripaska currently controls 70% of En+. En+ owns 48% of RUSAL but effectively controls it via a shareholder agreement.

The sanctions prohibit US persons from dealing with the sanctioned entities and people, and non-US persons could be sanctioned for knowingly facilitating significant transactions on behalf of those entities or people. The sanctions also prohibit the sanctioned entities from dealing in US dollars.

The sanctions effectively cripple RUSAL's business as it prevents US and non-US counterparties from transacting with the company, precludes the company from dealing in the core currency of its aluminium contracts, and puts a real strain on the company's ability to service its large debt load of ~US$8.8bn, ~90% of which is USD-denominated.

The aluminium cash price rose a massive 28% in response to the sanctions. It is perhaps no surprise then that the US Department of Treasury subsequently softened its stance towards RUSAL, inviting the possibility of lifting the sanctions if Deripaska relinquishes control of the company. OFAC has also subsequently extended (on several occasions) the deadline for trading in the company's securities and winding up dealings with the company, which is now 23 October.

En+, RUSAL and Mr Deripaska have shown a willingness to work towards a solution. The independent chairman of En+, Lord Barker, a British politician and former Energy Minister, has been aggressively working to lift the sanctions on En+ and RUSAL via a three-pronged approach known as the Barker Plan:

- reduce Deripaska's ownership stake in En+ below 50% (Rothschild has been hired to assist);
- remove Deripaska from the boards of both En+ and RUSAL (Deripaska has resigned from both boards); and
- replace Deripaska's allies on the boards and create a super-majority of independent directors (Deripaska-affiliated directors and executives have resigned, En+

working with OFAC to vet and approve new independent directors).

The Barker Plan is now in the final phase of implementation, namely the appointment of a new independent board and the reduction of Deripaska to minority shareholder status. We believe that OFAC will allow En+ and RUSAL time to implement this final phase, and that as a result RUSAL will eventually be removed from the sanctions list. If that happens, the share price should recover its lost ground. Even prior to the sanctions at a share price of HK$4.64 RUSAL looked cheap, 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. We invested at around half that price averaging in at ~HK$2.26 per share.

This investment is not without risks, however we believe the current entry point represents a unique opportunity to buy a world-class, low-cost, diversified asset base with brownfield growth potential at a severely depressed price, just as the company appears to be getting on top of its debt and long-term aluminium industry fundamentals look strong.