NGE Capital Limited

Investment and NTA update | As at 30 November 2018

NGE CAPITAL LIMITED SUMMARY

ASX ticker	NGE
Share price (30-Nov-18)	$0.600
Shares outstanding	37,238,552
Market cap	$22.3m
NTA per share after tax	$0.752
NTA	$28.0m

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

Level 4, North Building
333 Collins Street
Melbourne VIC 3000

+61 3 9648 2290

admin@ngecapital.com.au

www.ngecapital.com.au

NET TANGIBLE ASSETS (NTA) PER SHARE

	30 Nov 2018	31 Oct 2018
NTA per share before tax	$0.752	$0.798
Expected tax liability on realised and unrealised income and gains	($0.034)	($0.047)
Previously unrecognised tax losses now brought to account to reduce tax expense	$0.034	$0.047
NTA per share after tax	$0.752	$0.798

NTA PER SHARE PERFORMANCE SUMMARY

1 month	Year-to-date	Last 12 months	Since inception (1) (p.a.)	Since inception (1) (cum.)
-5.7%	19.3%	19.2%	21.4%	47.4%

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 a LIC.

TOP HOLDINGS (% OF NTA)

Company	Ticker	%
Powerwrap	Unlisted	21.3%
Yellow Cake plc	LSE:YCA	15.8%
United Company RUSAL	HKE:0486	14.5%
Eureka Group	ASX:EGH	9.5%
Horizon Oil	ASX:HZN	6.9%
Base Resources	ASX:BSE	6.3%

PORTFOLIO COMPOSITION

	30 Nov 2018
Listed equities	64%
Unlisted equities	22%
Convertible notes	3%
Cash less other net assets	11%
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 $22m 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 $23m of capital losses available as at 30 November 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 $0.33 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 -5.7% for the month of November. On a rolling 12-month basis, the portfolio is up 19.2%.

This month we reveal our latest investment, **Yellow Cake plc (YCA.LSE)**, which is an LSE-listed investment company whose investment strategy is to buy and hold physical uranium for the long-term. We have acquired 1.06m shares at an average of ~£2.26 per share.

Yellow Cake currently holds 8.44 mmlbs of "natural uranium" in the form of U_3O_8, which is also known as yellow cake. The company was formed to offer investors exposure to the uranium price without the risks typically borne by companies which explore for, develop and mine uranium. Yellow Cake is a simple, easy-to-understand play on the uranium price, as its Net Asset Value (NAV) should closely track the spot price.

Yellow Cake purchased its uranium holding in two transactions from the world's largest producer Kazatomprom (KAP.LSI) at an average price of US$21.10/lb, against the current U_3O_8 spot price of US$29.10/lb as at 30 November. Yellow Cake has an option to purchase up to US$100m of uranium per year from Kazatomprom until 2027 at the spot price at the time of purchase. This allows for an undisturbed purchase price when acquiring further uranium, an advantage that larger TSX-listed uranium holding fund **Uranium Participation Corporation (U.TSX)** does not enjoy.

Yellow Cake NAV

		As at 30-Nov-18
Uranium holdings	mmlb	8.44
Spot price	US$/lb	$29.10
Fair value of uranium	**US$m**	**245.6**
Cash [1]	US$m	9.5
Other net assets / (liabilities) [2]	US$m	-5.7
Net Asset Value	**US$m**	**249.5**
FX rate	GBP:USD	0.7840
Net Asset Value	**£m**	**195.6**
Shares out.	m	76.2
NAV per share	**£**	**£2.57**
Share price	£	£2.40
Discount to NAV	%	-6.5%

(1) NGE internal estimates as at 30 November.
(2) Includes 1% transaction fee on value of holdings upon exit and Kazatomprom repurchase option liability.

We briefly summarise the investment thesis for a uranium price recovery below.

URANIUM PRICE NEAR HISTORIC LOWS

The uranium price has risen 41% from a yearly low of US$20.50/lb in April. Despite the recent run, the price is still a long way from recovering from a prolonged bear market that has sent many uranium resource companies to the wall. For reference, prices reached US$143/lb in May of 2007.

GROWING NUCLEAR POWER DEMAND

According to the EIA World Energy Outlook, nuclear power capacity is expected to grow by 36% between 2015 and 2035 to meet growing demand for clean power generation, led by China and India. Base case uranium consumption is forecast to increase from ~173 mmlbs currently to ~190 mmlbs by 2030 (Bull Case ~260 mmlbs).

In addition, the Japanese nuclear industry is still slowly progressing through a recovery post Fukushima, with Prime Minister Abe's pro-nuclear government approving the restart of 9 reactors. Another 6 reactors have been approved for operations by the Nuclear Regulatory Authority; a total of 32 reactors could potentially restart operations by 2026-2027.

The large upfront capex required to construct a nuclear power plant, the long useful life (40+ years), and the inability to quickly turn a nuclear power plant on or off, means that utilities are to a certain extent relatively price insensitive to the uranium price, which makes up a relatively small portion of the marginal cost of running a plant. Of course when profit margins are tight small changes to the cost base can have a big impact to the bottom line, so we are cautious of the argument often made that utilities will buy uranium at any price.

Uranium consumption – potential increase in demand

451 **400**[1]	Nuclear power reactors **operable** GWe net installed capacity	**FY18E:** **173 mmlbs U_3O_8**
54 **58**	Nuclear power reactors **under construction** GWe gross installed capacity	**~34 mmlbs U_3O_8**[2]
148 **151**	Nuclear power reactors **planned** GWe gross installed capacity	**~88 mmlbs U_3O_8**[2]
337 **376**	Nuclear power reactors **proposed** GWe gross installed capacity	**~218 mmlbs U_3O_8**[2]

Source: UxC as cited by Kazatomprom, IPO prospectus 31 October 2018; WNA; NGE internal estimates.
(1) Net installed capacity is higher than operating capacity (e.g. Japanese reactors that are yet to restart post Fukushima are still classified as being operable).
(2) Uranium consumption estimates assume 0.58mmlbs U_3O_8 per GWe.

GLOBAL PRODUCTION CUTS

The spot price is unsustainable, as up to 60% of global production has total costs above current spot. Producers have been shielded from low spot prices by delivering into LT contracts at significantly higher prices. The majority of these contracts are expected to roll off over 2019-2022.

Producers are also reacting to market conditions and being more strategic in their actions. ~36-39 mmlbs of production cuts have been announced since 2016 by major producers including Kazatomprom, Cameco, Orano and Paladin Energy. Repositioning ahead of its recent IPO, Kazatomprom has switched to a "value over volume" strategy.

Cameco has resorted to purchasing volumes in the spot market (11-15 mmlbs over 2018-2019) to meet its LT obligations after mothballing production at McArthur River (mining capacity ~18 mmlbs p.a.) for an indefinite period. In addition a number of financial players, such as Yellow Cake, have entered the market and sequestered significant volumes from the spot market.

CURRENT SUPPLY DEFICIT FORECAST TO GROW

The 2018E global supply deficit of ~30 mmlbs is being met by secondary supply and depleting inventories. Production cuts, underinvestment in new mine development, and growing demand mean the supply deficit is forecast to grow to ~80 mmlbs by 2030 (Bull Case ~145 mmlbs) according to UxC. The uranium price needs to increase substantially to restart mothballed mines and incentivise capital investment in new mine supply.

UNCOVERED DEMAND

According to UxC, utilities are forecast to have uncontracted demand of ~40 mmlbs of uranium by 2021, rising to ~95 mmlbs by 2025 and ~125 mmlbs by 2030. Tightened supply means utilities are faced with buying uranium on the spot market or entering into LT supply contracts at prices that allow producers to earn an acceptable return on capital – industry sources reckon this means prices of at least ~US$45-50/lb.

Adding to the picture is the Section 232 action in the US, that is creating further pent-up demand from US utilities. The US is the largest consumer of uranium globally, with annual demand of ~45 mmlbs. Combined with uncontracted demand, there is the potential for a rapidly tightening spot market.

THE BIG UNKNOWN: INVENTORIES

There are widely varying estimates of the global level of inventories. The estimates can be confronting (~850+ mmlbs), and represents many years' consumption. However, the counter-argument is that the "saleable" inventory is much less, as governments and utilities like to hold strategic inventories equivalent to a number of years of future uranium needs. Whilst this theory has yet to be fully tested, the recent run in spot price suggests that there is not necessarily a large volume of ready-made inventory available.

In summary, we think Yellow Cake provides an investment with low downside risk (perhaps 25-30%), with high potential upside.

During the month the new board of **Millennium Services (MIL)** provided updated earnings guidance following receipt of preliminary results of a strategic review conducted by an external corporate advisor. We excerpt part of the announcement below:

> *The consultant's Preliminary Report notes that this revenue growth has been at lower gross profit margins than historically generated by the Company. As a result, Millennium's overall profitability has been negatively impacted and, should current trends continue, the Company's FY19 EBITDA is anticipated to be at close to breakeven levels. This is significantly below the guidance provided by the Company on 31 August 2018 (issued by the previous board).*

This was a very shocking update: only three months ago the company put out guidance that the company should make FY19E EBITDA of $15.5-17.5m from revenue of $290-310m. After missing every single earnings guidance number put out to the market since listing in November 2015, and being heavily punished for it, we understood that the company was applying ultra-conservative assumptions to its forecasts. Whilst the revenue forecast looks to be on track, we are now told that EBITDA might be closer to zero. Clearly the business was in worse shape than the previous management and board realised. The share price fell 42%, to all-time lows of $0.23.

We apologise to our shareholders for getting this investment so very wrong. Our unrealised loss on our investment amounts to approximately 4.7% of our current NTA. With such a low margin business (FY18 statutory gross margin was 14.5%), and overheads tracking at ~$33m (~11% of FY19E revenue), there is little room for error. Regardless of whether the company is disciplined in tendering for new business, if focus is taken off the day-to-day operations, issues such as poor rostering (which leads to unnecessary overtime and overstaffing of sites) quickly erode profits. It appears that the business has also been affected by an unusually large increase in July of the FWC award for cleaning and security of 3.5% (FY17: 3.3%; FY16: 2.4%; FY15: 2.5%), which may not be fully recoverable across a significant number of contracts.

Add to the above the large debt load being carried following the Airlite acquisition in 2016, and things look somewhat precarious. The company is at risk of breaching its debt covenants at 31 December, as it did at 30 June. Any turnaround and restructuring story will require buy-in from the company's lender, ANZ. However, we believe that on the balance of probabilities ANZ will prefer to give the new board a chance to turn the business around. Despite the rapid decline in profitability, it does not mean the company is beyond being fixed and not good value at these levels, and at risk of throwing good money after bad we have upped our stake slightly at 23¢, though our total holding now only represents ~2.7% of NTA. Our sense is that with a few tweaks to rostering, and a significant cut to corporate overhead, the business will return to profitability again.