Investment & NTA Update

28 February 2022

NGE Capital Summary

ASX ticker	NGE
Share price (28 Feb 22)	$0.775
Shares outstanding	36,065,025
Market cap	$28.0m
NTA per share before tax	$1.005
NTA per share after tax	$1.069
NTA before tax	$36.2m
NTA after tax	$38.6m

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

	28 Feb 2022	31 Jan 2022
NTA per share before tax	$1.005	$0.966
NTA per share after tax	$1.069	$1.031

NTA Per Share Performance Summary

			Since inception[1]	
1 month	Year-to-date	Last 12 months	(p.a.)	(cum.)
4.0%	2.6%	24.0%	13.8%	97.0%

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	16.7%
Metals X	ASX:MLX	10.9%
Jupiter Mines	ASX:JMS	5.6%
Evolve Education Group	ASX:EVO	5.2%
Humm Group	ASX:HUM	4.9%
Sprott Physical Uranium Trust	TSX:U.UN	4.7%
Allegiance Coal	ASX:AHQ	4.1%
Geo Energy Resources	SGX:RE4	3.4%
Capricorn Energy plc	LSE:CNE	3.2%
John Wood Group plc	LSE:WG.	2.8%
International Petroleum	TSX,STO:IPCO	2.5%
Austin Engineering	ASX:ANG	2.3%
U.S. Silica Holdings, Inc.	NYS:SLCA	2.2%
Medusa Mining	ASX:MML	2.1%
Base Resources	ASX:BSE	1.9%
Consorcio ARA	MEX:ARA	1.4%
Net cash and other		26%
Total		100%

Unrecognised Tax Losses

The Company has ~$41 million of Australian unused and unrealised losses available as at 28 February 2022. In the aggregate these losses equate to a potential future tax benefit of ~$10m 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).

Commentary

28 February 2022

In the Chairman's Letter of NGE's 2021 Annual Report, published on 28 February 2022, we noted that we are increasingly focusing more of our time on event-driven special situation trades which tend to be less correlated with the market. We encourage investors to read the letter, which also covers some of our key portfolio holdings. It can be accessed here.

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During February we initiated significant portfolio positions in **Capricorn Energy plc (LSE:CNE)** and **Humm Group Limited (ASX:HUM).** We also purchased two smaller positions in **Medusa Mining Limited (ASX:MML)** (1m shares at ~$0.78 per share) and **U.S. Silica Holdings, Inc. (NYS:SLCA)** (39k shares at ~US$9.62 per share). We also added to our position in **John Wood Group plc (LSE:WG.)** (current holding 300k shares at ~GBP1.91 per share). We talk through our investment theses on Capricorn and Humm in detail below.

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We purchased ~275.5k shares of **Capricorn Energy** during the month, and acquired more shares since month end taking our total holding to 470k shares acquired at ~GBP2.195 per share.

Capricorn Energy, formerly Cairn Energy, is an oil and gas producer and explorer listed on the LSE. It has been one of the more successful frontier-type exploration companies to come from the LSE, at least when compared to the performances of **Tullow Oil plc (TLW.LSE)** and Premier Oil (since subsumed into **Harbour Energy plc (HBR.LSE)**).

Capricorn looks cheap to us with an EV of ~US$200m based on the month-end share price of GBP2.22, after taking into account a large tax refund of US$1.06bn just received from the Indian Government and a US$76m earn-out to be received in the next few months. For an EV of US$200m we get Egypt production assets acquired for US$323m (+ up to US$140m of earn-outs if certain conditions are met) in September 2021 when the Brent crude price was ~US$75/bbl, earn-outs from prior asset sales worth perhaps ~US$100-200m on a PV basis (with upside risk), and some exploration assets with a book value of ~US$100m.

The Egypt assets were valued at ~US$415m on a net entitlement 2P Reserves basis as at 31 December 2020 by an independent expert, using the following Brent crude price deck:

2021	2022	2023	2024	2025+
$51.38	$54.00	$57.00	$60.00	+2% p.a.

Capital structure		GBP	USD
FX rate	1 USD:GBP		0.7600
Share price (28-Feb-22)	$	2.222	
Shares out.	m	495.3	
Market cap	**$m**	**1,101**	**1,448**
Cash (31-Dec-21)	$m		314
India tax refund	$m		1,060
North Sea 2021 earn-out	$m		76
Egypt earn-out	$m		-21
Pro forma cash	**$m**		**1,429**
Drawn debt	$m		181
Pro forma net cash	**$m**		**-1,248**
EV	**$m**		**200**

Rolling forward the NPV valuation to the point of acquisition (23 September 2021) using the same price assumptions suggests a valuation roughly in-line with what Capricorn paid Shell. Of course, those price assumptions now look conservative, suggesting significant upside to what Capricorn paid.

If Brent averages US$85-105/bbl in 2022, we estimate the Egypt assets could do ~US$80-110m of FCF this year at the midpoint of production guidance (37,000-43,000boepd) and after accounting for US$90-110m of production and development capex.

The company has launched a Tender Offer to buy back up to US$500m of stock which should complete in mid-April, and will thereafter buy back shares on-market up to US$200m. The Tender Offer price will be done within a range based on a 5-day daily VWAP up to and including the Closing Date of 5 April, and 5% above the VWAP. The Tender Offer represents ~35% of shares outstanding, and the US$200m on-market buyback another ~15%.

The share price has fallen by ~10% since the end of the month which is annoying. However, a weak share price in the short-term should work in our favour given the dynamic price structure of the Tender Offer. A high take-up rate coupled with a low price would be ideal for us. It is also worth noting that because the pro forma cash balance is so large relative to the market cap, the EV is very sensitive to moves in the share price: a 1 penny move equates to a change of +/- ~US$6.5m in the implied EV. At a share price of GBP2.00, a decline of ~22p or ~10% from month end, the EV is only ~U$55m (a drop of 72.5% from US$200m).

Capricorn is not a perfect story given the key producing assets are in Egypt, ~2/3 of production is gas which is predominantly sold at a fixed price to government entity Egyptian General Petroleum Corporation (EGPC) ("lost" profits in a high gas price environment), EGPC has a preferential right to purchase part of Capricorn's crude and condensate production, payments by EGPC are typically made several months in arrears on an "irregular and unpredictable basis", and profits (over and above "cost petroleum") are taxed heavily. In addition 2022 is a heavy capex and exploration year with a program to spend ~US$200m, though drilling commitments beyond 2022 appear to be much lower. Nevertheless, it seems hard to lose from here in the next 6 months or so given the sky-high Brent price and a large buyback coming in the next few months.

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During February we acquired 2m shares of **Humm Group Limited (ASX:HUM)** at an average price of ~86.3c per share (adjusted for 1.7c dividend to be received).

Humm is perhaps better known by its former company name, Flexigroup, and has been listed on ASX since 2006. Humm is a non-bank lender operating two divisions – Humm Consumer Finance (HCF) and Flexicommercial (FC). HCF offers buy-now-pay-later (BNPL) and credit card products targeted to consumers and businesses, while FC offers equipment financing to SMEs. Humm operates in Australia, New Zealand and Ireland, and recently expanded into the UK and Canada.

The company has been one of the few profitable BNPL players in the market, likely due to its offering being targeted towards larger purchases (up to $30,000) that are meaningful to the borrower. HCF's top earners are retail point-of-sale, BNPL loans used to finance solar equipment, medical services, jewellery and home items.

Flexicommercial's top products are lease financing for transport vehicles (e.g. trucks), construction vehicles (e.g. excavators), and light commercial vehicles (e.g. utes).

Growing lending businesses like Humm are amongst the riskiest types of investments, and we tend to steer clear of them. It is easy to grow a loan receivables book very quickly by accepting poorer quality credits and/or lowering vetting standards, and there is management discretion in provisioning for credit losses today against expected loss experience in future. When the loan balances get very large, it doesn't take much to wipe out a lifetime of profits if loss experience exceeds expected outcomes by even a small amount. We recall the experience of SilverChef (ASX:SIV) and AxsessToday (ASX:AXL) which both unravelled quickly despite being market darlings at one time or another. Thankfully we did not touch either.

So why do we like Humm? The company is in play, with an agreed offer from **Latitude Group Holdings Limited (ASX:LFS)** to acquire the HCF business, and Cerberus and PE-backed Scottish Pacific have reportedly made approaches for the FC business.

Latitude's offer of 0.3x LFS shares and $0.07 cash per share is worth ~49c-67c at a LFS share price of $1.40-2.00. The deal was struck at a LFS price of $2.00, but we expect the share price to decline initially on heavy selling once Humm shareholders are issued an aggregate 150m shares (~13% of Latitude's pro forma shares outstanding).

Latitude's shares are very illiquid despite its ~$2.0bn market cap (as at 28 February), trading only ~$190k per day prior to the deal announcement. That is a function of the inability of the company to get an IPO away in 2018 and 2019, finally opting instead to do a compliance listing in 2021. As a result ~69% of shares are held by KKR, Deutsche Bank, and Varde, and a further ~10% is held by Shinsei.

The market clearly hates the deal, which is probably due to a combination of the stock-heavy nature of the consideration, the low liquidity of Latitude's shares, the private equity overhang in Latitude, and the fact key pertinent terms have yet to be released to the market (e.g. Material Adverse Change clauses). Other things to contend with include Latitude's intangibles-heavy balance sheet (high even for a non-bank lender) and its liberal approach to adjusting earnings. The deal also needs shareholder approval via a Scheme of Arrangement, which requires:

- 75% of the votes cast on the resolution; and
- More than 50% in number of shareholders voting on the resolution.

That might be an issue given the number of shareholders is high (~18k per AR 2021), with ~12k holding 5,000 shares or less.

Latitude's 15.7c trailing dividend should provide some backstop to any share price fall post deal. The improved free float resulting from the deal might attract interest in Latitude from institutional investors, and may also result in inclusion in the ASX300 index which would create forced buying by index funds. Additionally, if a meaningful portion of the slated $55m of cost synergies are real then the acquisition will look very attractive.

On a pro forma FY22E basis (31 Dec year end), Latitude will look ok

Commentary

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after the HCF deal assuming:

- $2.00 LFS share price
- 150m new LFS shares issued
- $210m CNPAT for Latitude (we add back "significant items" that appear to be opex in nature, tax-effected at 30%, and include $4m of Sympl synergies and allow for some growth)
- $30m CNPAT for Humm Consumer ($25m run-rate in 1H22, which was suppressed by international expansion and new hires)
- After-tax synergy realisation to 31 Dec 2022 of $7m (50% of Duplicate Costs of $20m, tax-effected)

We get a pro forma P/E of ~9.6x, EPS accretion of ~2.8%, and P/B of ~1.3x. These seem like reasonable metrics to us.

Humm will be left with the Flexicommercial business and unrestricted cash of ~$124m (adjusted for 1.7c dividend) less Perpetual Notes of ~$55m due to be paid down post deal. At the month end share price of 88c, the implied value of the FC business is ~7-25c after deducting the HCF deal consideration (~49-67c) and net cash of ~14c. That equates to ~$35-125m for a business doing ~$31m CNPAT (1H22 run-rate), or ~1.1-4.0x. That is far too cheap, especially given the likelihood of a sale of the business in the next six months. A deal could conceivably be done at 10x+: although not perfect comps, Affinity paid ~3x BV and a P/E of ~20x for Scottish Pacific in 2018, and **EarlyPay Ltd (ASX:EPY)** trades at ~9.5x.

At a more reasonable valuation range of 6-10x CNPAT for FC we think Humm is worth ~$1.00-1.45 per share or ~15-65% upside to our entry price. The key risk – beyond a blow-up of the loan book – is that the Latitude deal does not close. In that instance we would be left invested in a business doing ~$55m CNPAT (1H22 run-rate) – with earnings held back in 1H22 by international expansion and new hires – and trading at a ~7.9x trailing P/E and ~0.7x P/B. That would not be an ideal outcome, but we don't think we lose much under such a scenario.

Humm valuation		Low	High
Share price (28 Feb 2022)	$/sh	$0.880	$0.880
Shares out.	m	495.3	495.3
Market cap	**$m**	**435.8**	**435.8**
Unrestricted cash	$m	132	132
Less: interim dividend	$m	-8	-8
Less: Perpetual Notes	$m	-55	-55
PF unrestricted cash	**$m**	**69**	**69**
PF unrestricted cash	**$/sh**	**$0.14**	**$0.14**
Commercial FY22E CNPAT	$m	31	31
P/E	x	6	10
Commercial valuation	$m	186	310
Commercial valuation	**$/sh**	**$0.38**	**$0.63**
Humm Consumer Sale Consideration			
Cash	$m	35	35
Cash	**$/sh**	**$0.07**	**$0.07**
Latitude shares	#	0.3	0.3
Latitude share price	$/sh	$1.40	$2.00
Latitude shares	**$/sh**	**$0.42**	**$0.60**
Total LFS consideration	**$/sh**	**$0.49**	**$0.67**
Value per share	**A$**	**$1.00**	**$1.44**
Upside	*%*	*14%*	*63%*

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Based on ASX close prices as at 11 March and international close prices as at 10 March our pre-tax NTA per share is ~$1.029.

Announcement released to the market with the authorisation of:

David Lamm	Adam Saunders
Chief Investment Officer	Portfolio Manager