NGE Capital Limited

Investment and NTA update | As at 31 August 2018

NGE CAPITAL LIMITED SUMMARY

ASX ticker	NGE
Share price (31-Aug-18)	$0.660
Shares outstanding (31-Aug-18)	37,316,065
Market cap	$24.6m
NTA per share after tax	$0.795
NTA	$29.7m

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

	31 Aug 2018	31 July 2018
NTA per share before tax	$0.795	$0.810
Expected tax liability on realised and unrealised income and gains	($0.046)	($0.050)
Previously unrecognised tax losses now brought to account to reduce tax expense	$0.046	$0.050
NTA per share after tax	$0.795	$0.810

NTA PER SHARE PERFORMANCE SUMMARY

			Since inception (1)	
1 month	Year-to-date	Last 12 months	(p.a.)	(cum.)
(1.9%)	26.2%	28.0%	28.9%	55.9%

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	20.1%
United Company RUSAL	0486.HKE	13.3%
Eureka Group	ASX:EGH	8.0%
Not disclosed	Listed	7.5%
Base Resources	ASX:BSE	6.7%
Not disclosed	Listed	4.0%
Millennium Services	ASX:MIL	2.6%

PORTFOLIO COMPOSITION

	31 Aug 2018
Listed equities	45%
Unlisted equities	21%
Convertible notes	3%
Cash less other net assets	31%
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 August 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 $0.32 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 -1.9% for the month of August. On a rolling 12-month basis, the portfolio is up 28.0%.

Powerwrap Limited is our largest portfolio investment. Powerwrap is an unlisted public company that provides investment portfolio administration services. The company operates in a very attractive market supporting independent financial advisors in managing their clients' wealth.

The company is not yet profitable but has been growing rapidly. As at 30 June, the company had $7.12 billion in funds under administration (FUA), up 22% over the year. Platform revenue increased 26% to $14.6m, and EBITDA adjusted for one-offs improved to -$1.8m (FY17: -$3.5m).

Powerwrap announced it is targeting an ASX listing in the first half of calendar year 2019. The company is likely to be compared to listed peers Netwealth (ASX:NWL), HUB24 (ASX:HUB) and Praemium (ASX:PPS). The below table shows that, based on month end share prices, peers trade on EV / FY18 Revenue multiples of between 9.8x and 23.6x:

Company	FUA $bn	Mkt cap $m	EV $m	FY18 Revenue $m	FY18 EBITDA $m	EV / Revenue x
Netwealth	18.0	2,023	1,970	83.3	42.3	23.6x
HUB24	8.3	846	829	84.0	11.4	9.9x
Praemium	8.3	437	424	43.2	8.8	9.8x
At NGE carrying value of $0.10 per share:						
Powerwrap (1)	7.1	75	64	14.6	-1.8	4.4x

Note: FUA as at 30 June 2018.
Market cap based on share price as at 31 August 2018.
(1) Revenue excludes R&D rebate of $2.5m.

We are comfortable that our carrying value of $0.10 per share is reasonable, as it implies an EV/Revenue multiple of 4.4x, well below comparable company valuations.

If we adopt a ~20% private company discount to the lowest multiple in this peer group and apply this to Powerwrap's platform revenue, we arrive at a rough back-of-the-envelope value of ~$0.17 per share, ~70% above our current carrying value:

Back-of-the-envelope valuation of Powerwrap		
FY18 platform revenue	$m	14.6
EV/Revenue	x	8.0
Enterprise Value	**$m**	**116.8**
Cash (30 Jun 2018)	$m	11.5
Equity value	**$m**	**128.3**
Shares outstanding	m	754.1
Equity value	**$/share**	**$0.170**

Eureka Group Holdings Limited (ASX:EGH) reported a reasonable result, all things considered. The core business – providing low cost rental accommodation to independent retirees of limited means – is performing pretty well with occupancy rates finishing the year at 92.9%.

A key issue has been that previous management tied up valuable capital in non-core property deals that proved a huge and costly distraction. When put to work in the right places, the company earns ~11% EBITDA returns on its invested capital at the property level. Currently the company has ~$20m of capital tied up in non-core assets (including $3.6m cash received post month end), which if applied to sensible leveraged acquisitions of additional villages could generate a further ~$4.0-4.5m of EBITDA (versus FY18: ~$7m). Applying a conservative EV/EBITDA multiple of 12.0x to these additional (fictitious!) earnings would result in a share price boost of ~$0.12-0.15, or ~45-55% upside from month end share price of $0.27.

Eureka will take patience to play out. As always, legacy issues take longer to solve than incoming managers expect and investors hope. The initial indications are that the new board and management are doing the right things to clean up the business, though it is still early days.

Base Resouces Limited (ASX:BSE) reported strong operating cash flow of US$117m in the financial year to 30 June, due to consistent production and increased commodity prices across Base's key products of rutile, ilmenite and zircon. A recently completed optimisation project to improve mining rates and wet concentrator plant throughput should help to mitigate the effects of a declining resource grade in the remaining life of mine.

Based on current spot prices of its key commodities, Base's Kwale project should throw off a similar amount of cash this year, which will enable the company to fully pay down its outstanding debt. Apart from consistent production and ongoing strength in mineral sands prices, key drivers of future value will be:

- Remaining mine life of Kwale: currently ~6 years based on estimated ore reserves, though could be extended with a successful exploration drilling at North Dune which is currently in progress;
- Toliara Project economics: once Base has published a pre-feasibility study on Toliara, likely early next year, investors will have a better understanding of the potential value and capex requirement (our industry sources tell us that this is a world class asset); and
- Toliara funding: if Base can line up a sizeable debt package and/or sell down part of the project to a strategic investor, it will reduce the company's equity funding requirement.

On a DCF basis, we value the Kwale operations at ~$0.40-0.50 per share (net of debt), well above the month end share price of $0.27. The value of the Toliara development project is unknowable at this stage, but we estimate it could be worth an additional ~$0.15-0.30+ per share (net of capex requirement), meaning we are getting exposure to this blue-sky project for nothing.

Millennium Services Group Limited (ASX:MIL) produced a disappointing FY18 result, which saw the share price decline 16% on the announcement date (which coincided with month end). As at the time of writing, the share price has declined a further 33%.

Millennium must surely be one of only a few companies that has managed to double revenues, increase operating profit but destroy 75% of its share price since listing. Question marks do remain as to the margin quality of new contract wins, and the multiple earnings downgrades and management personnel changes since listing coupled with a lack of stock liquidity mean that Millennium is definitely in the "unloved" category of investment.

However, we are not yet ready to lose faith with our earlier assessments that Millennium is now being run by a sensible, experienced management team that is taking a disciplined approach to its tendering activities, and the Security division represents a big opportunity for growth.

Finally, we have recently made recent investments in **two as yet undisclosed listed companies**, which we will disclose in the future.