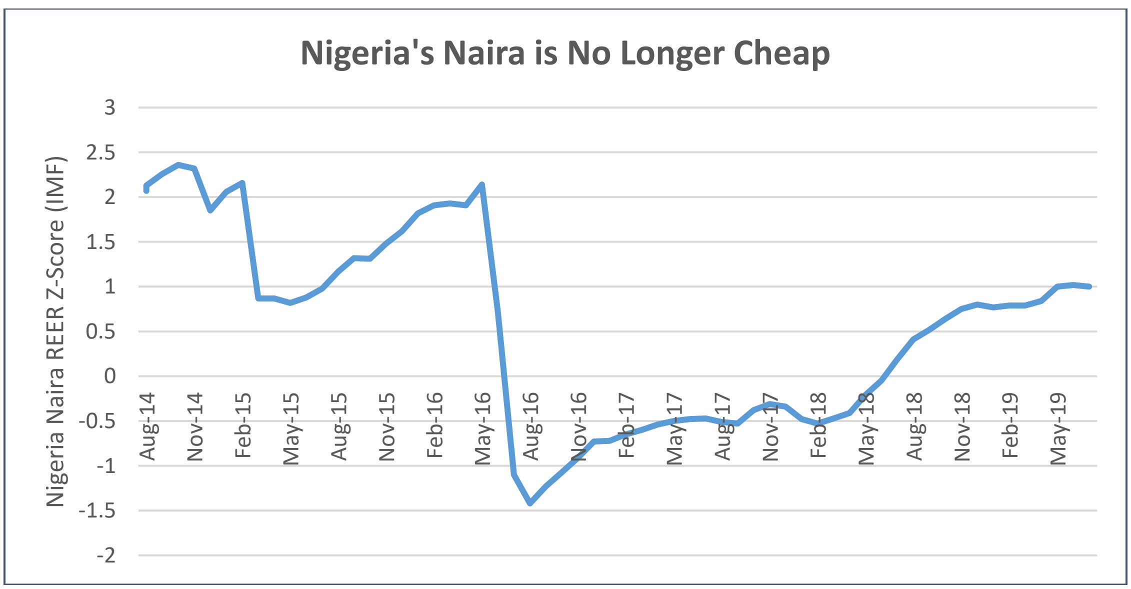
Kyklos Capital

OUTLOOK: Soft Money in Hard Places

"The meek shall inherit the earth, but not its mineral rights." **J. Paul Getty**

Kyklos's portfolio in July featured an interesting laggard, which was Seplat Petroleum, a Nigerian oil and natural gas producer. Nigeria, a feature of Kyklos's March monthly letter following a visit, sports a macro picture that is largely negative, with a fumbling government, poor GDP growth prospects, security issues and demographic pressures. The fund has owned Seplat since inception. One could reasonably ask, Why?

First, investors in Nigerian oil and gas, which is priced in US dollars, benefit from a natural hedge against potential weakness in Nigeria's naira currency, in which they pay some 30% or more of their bills. The naira is at risk of an eventual devaluation (below), which would cut the US dollar value of Seplat's assets in Nigeria. However, in US dollar terms, that would also reduce the local costs which are paid in devalued naira, and so boost company earnings and support the share price. The cost of direct hedges on the naira are too high to consider, with interest costs in double digits.



1350 Avenue of the Americas
2nd Floor
New York, NY 10019
t: 646.738.8078
cgushee@kykloscapital.com

Kyklos Capital

Second, there is growth in the business. Seplat has doubled its energy production over seven years despite Nigeria's difficult operating conditions, and there is more to come. In natural gas, Seplat is expanding aggressively. It sells to Nigerian customers at an 80% discount to the main competing product, which is diesel to run electricity generators. As most natural gas produced today is burned at the well, and most homes still do not have electricity, Seplat is positioned for years of growth with more stability in local gas prices than those of the global markets. And with almost no debt, the company can acquire additional productive Nigerian assets on the cheap, should there be an auction, since foreign competitors are now excluded from most local auctions under a 2010 law and other Nigerian players are highly indebted.

And finally, the stock's valuation is extremely cheap. Its trailing PE ratio is about 5, price-to-book is 0.5, and dividend yield is over 7%. On enterprise-value-per-barrel-of-2P-reserves-- a fancy measure of what one pays for oil in the ground-- Seplat's oil is valued at under $1.20 per barrel, amongst the cheapest in the world. All this implies that the share price could multiply several times over in coming years. Seplat offers enough potential reward to make up for some Nigerian risk.

In a quiet July for corporate access, I spent most of a day meeting with participants and company management from Uzbekistan. The most interesting takeaway was that several dozen portfolio managers showed up to kick the tires on the country's investment case, a big turnout for a small market. The attraction of the story is straightforward: like the Eastern Europe of the late 1990s or Africa of the early 2010s, Uzbekistan is experiencing a generational political and economic opening, with reformers replacing a leftover Soviet regime only three years ago. As a portfolio investment opportunity, it is early days, with its stock market lacking a full central custodian, extremely low trading liquidity, and a regulatory and legal platform still a work in progress. Local companies are interested in getting listed via IPOs, but it is an open question whether they will do so in the local market, or others such as London following common Russian practice. It's on the radar for now.

Charlie Gushee
August 1, 2019

1350 Avenue of the Americas
2nd Floor
New York, NY 10019
t: 646.738.8078
cgushee@kykloscapital.com

Kyklos Capital

IMPORTANT DISCLOSURE INFORMATION

This information is intended solely for the addressee, for informational purposes only, is confidential, is not intended for public use or distribution, and may not be reproduced or distributed without the express written consent of Kyklos Capital LLC ("Kyklos Capital") or Charles Gushee.

In addition, the positions discussed in this letter are being provided only for illustrative purposes in order to provide examples of the idea generation, research, and investment process of Charles Gushee. The issuers discussed in this letter do not represent all of the positions selected by Charles Gushee in the Fund. No representation is made as to whether or if the investment ideas represented in the positions discussed in this letter have been or will be profitable. It should not be assumed that Kyklos Capital will be able to identify similar investment opportunities in the future or that any such opportunities will be profitable.

The information in this letter is current only as of the date indicated, and may be superseded by subsequent market events or for other reasons. Statements concerning financial market trends are based on current market conditions, which will fluctuate.

This information does not constitute an offering of any security, product, service or fund, including interests in the Fund. An offer or solicitation of an investment in the Fund will only be made pursuant to a confidential private offering memorandum (the "Private Offering Memorandum") and other documents of the Fund (the "Fund Documents") in jurisdictions where permitted by law, and only the information in the Fund Documents should be relied upon when making a decision to invest.

The purchase of interests in the Fund is speculative and suitable only for sophisticated investors for whom an investment in the Fund does not constitute a complete investment program and who fully understand and are willing to assume the risks involved in the Fund's investment program. The Fund will employ certain trading techniques, such as short selling and the use of leverage, which may increase the risk of investment loss. As a result, the Fund's performance may be volatile, and an investor could lose all or a substantial amount of his or her investment. Further, the Fund has substantial limitations on an investor's ability to redeem or transfer its interests, and there is no secondary market for interests in the Fund and none is expected to develop. All of these risks, and other important risks, are described in detail in the Fund's Private Offering Memorandum. Prospective investors are strongly urged to review the Private Offering Memorandum carefully and consult with their own financial, legal and tax advisors **before** investing.

This information is not for distribution in isolation and must be viewed in conjunction with the Fund Documents as it is not intended to be a complete description of the risks of an investment in the Fund or its investment strategies. To the extent there is any inconsistency between this information and any of the Fund Documents, the Fund Documents govern in all respects. Although the information contained herein is believed to be accurate as of the letter date, Kyklos Capital and Charles Gushee do not make any warranty regarding its accuracy or completeness, and will not accept responsibility for any errors in the information, and undertake no obligation to update any information set forth herein. Any projections, market outlooks, or estimates in this document are forward-looking statements based upon certain assumptions, and should not be construed to be indicative of the actual events that will occur. Any information regarding portfolio composition or investment restrictions are intended as examples or guidelines which may be modified or changed by Kyklos Capital at its discretion and without notice to you. Further, as noted in the document, all positions discussed are positions that were held in the Account, which is intended to serve as the development account for the Fund, and such positions do not necessarily represent the positions that will be held by the Fund.