NAOS QUARTERLY INVESTMENT REPORT

Q3 FY23

ASX: NCC | NAOS EMERGING OPPORTUNITIES COMPANY LIMITED
ABN 58 161 106 510

ASX: NAC | NAOS EX-50 OPPORTUNITIES COMPANY LIMITED
ABN 49 169 448 837

ASX: NSC | NAOS SMALL CAP OPPORTUNITIES COMPANY LIMITED
ABN 47 107 617 381

Q3 FY23 SUMMARY

Dear Fellow Shareholder,

Q3 FY23 brought with it half year financial results for all but a few of the core investee companies across the NAOS LICs. This reporting season was eagerly awaited by investors, not only to see how businesses had fared over the previous 6 months, but also for changes they had seen following the significant increases in interest rates and volatile macro backdrop.

The macroeconomic backdrop continues to have a significant influence on where investors are willing to invest and the level of risk they are willing to take, especially over the short term. It is noteworthy how the tone has recently changed from how high interest rates will need to go to curb inflation, to what the unintended or unforeseen consequences may be from the significant rises in interest rates we have seen globally.

Until recently, much of the focus has been on the consumer, especially those with mortgages who are more susceptible to interest rate increases in the short term. However, this focus has suddenly shifted to the impact on the banks that provide these consumers and businesses with the funding they require to operate on a day-to-day basis.

Banks have arguably believed that depositors were sticky customers who would rarely consider moving these deposits. What has occurred more recently is that the depositors have moved to other financial institutions at such volumes that some banks have been forced to sell assets at a discount to what was believed to be fair value. As this cycle gained momentum a few banks have been left with a capital shortfall, essentially leaving them insolvent and requiring a strategic alternative e.g., Silicon Valley Bank (SVB) and Signature Bank.

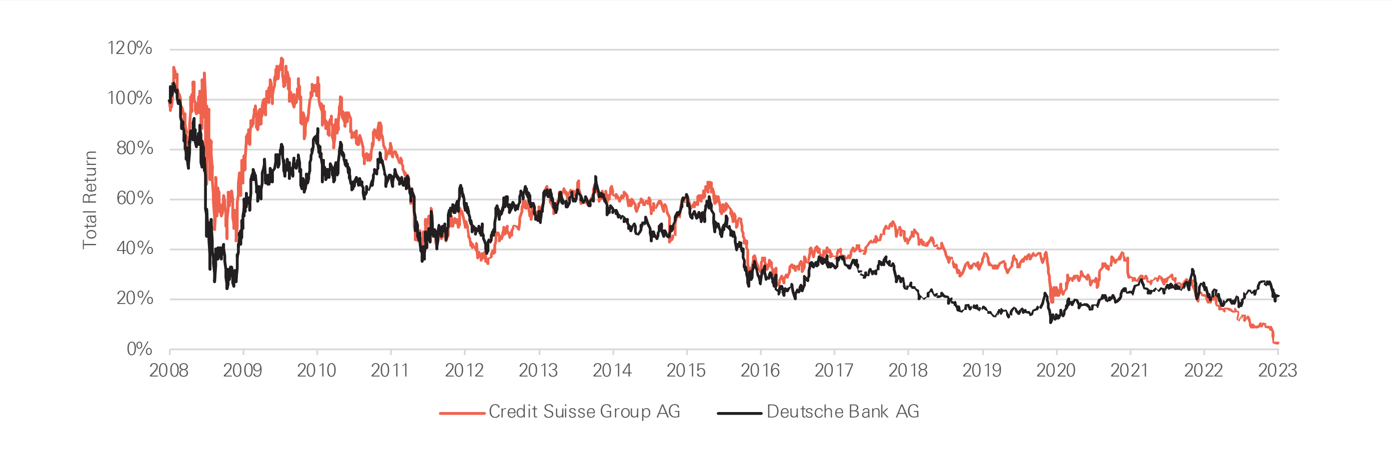
Admittedly, there are significant differences between Australian, US and European banks and their capital requirements but what they do have in common is that they provide a significant amount of liquidity to the broader economy, which is crucial for any semblance of a normal operating environment. As we saw in the GFC, fundamentals and facts can take a back seat to emotions, which can lead to fear and contagion, which is extremely hard to stop once momentum has kicked in.

What all investors should be cognisant of is the impact of any significant changes in the availability of credit i.e., where, how much, and on what terms banks are willing to lend to other counterparties. In Australia we have not witnessed any changes to such liquidity, but these things have a habit of creeping up very quickly.

At a stock specific level, we are yet to see evidence of reduced demand as a result of decreased consumer/ business confidence, which gives us confidence that many of our investments remain significantly undervalued on a long-term investment horizon. Importantly we have also placed a significant amount of emphasis on the liquidity positions of each of these businesses which we believe puts them in a position of strength should liquidity continue to come under pressure globally.

Finally, to highlight just how far some European financial institutions have fallen, we have included a chart below outlining the total return of Credit Suisse and Deutsche Bank over the last 15 years.

15 Year Total Return - Credit Suisse & Deutsche Bank



Source - Factset

INVESTMENT PORTFOLIO PERFORMANCE SUMMARY

Investment Portfolio	Q3 FY23 Performance	Q3 FY23 Benchmark Performance^	3 Year Performance (p.a.)	3 Year Benchmark Performance (p.a.)^	Inception Performance (p.a.)	Benchmark Inception Performance (p.a.)^
NCC Investment Portfolio Performance*	+3.71%	+1.88%	+15.31%	+13.16%	+9.72%	+4.86%
NAC Investment Portfolio Performance*	+2.35%	+2.34%	+17.40%	+13.04%	+9.68%	+6.55%
NSC Investment Portfolio Performance*	+7.46%	+1.88%	+17.43%	+13.16%	+3.68%	+3.71%

*Investment Portfolio Performance is post all operating expenses, before fees, interest, taxes, initial IPO commissions and all subsequent capital raising costs. Performance has not been grossed up for franking credits received by shareholders. Since inception (P.A. and Total Return) includes part performance for the month of February 2013 (NCC), November 2014 (NAC) and December 2017 (NSC). Returns compounded for periods greater than 12 months. All figures as at 31 March 2023.
^NAC Benchmark= S&P/ASX 300 Industrials Accumulation Index, NCC & NSC Benchmark= S&P/ASX Small Ordinaries Accumulation Index.

NOTABLE INVESTEE COMPANY UPDATES

COG FINANCIAL SERVICES

ASX: COG

Q2 FY23 Events: HY Result & Acquisition

In Q3 FY23 COG released their 1H FY23 results and later in the quarter announced the acquisition of a salary packaging and novated lease business called Paywise.

Touching on the HY result, the reported profit was marred by the poor performance of Earlypay (ASX: EPY), of which COG owns ~20% and equity accounts its share of the EPY profits (or losses in this case). As EPY reported a HY loss of -$5.43 million, COG's HY results reflected 20% of this loss through its own P&L. EPY has gone through a significant amount of change at many levels including board, management, operations and risk management. Post these changes EPY have stated they remain confident in returning to profitability over the short to medium term. In our view, we do not see the logic in COG being a minority shareholder given this strategy has been detrimental for COG shareholders. In our view, management needs to execute on a strategy to either move to full ownership and integrate EPY or sell out completely, as we believe it is key that management are able to remain fully focussed on the core COG strategy. We believe this course of action would command a higher earnings multiple compared to the EPY business over the medium term.

At the end of Q3, COG announced the acquisition of salary packaging and novated leasing business Paywise, for a total consideration of $30 million. Concurrently, COG entered into an agreement with EML Group to sell 18% of COG's entire novated leasing business (post-acquisition) for a consideration of $15 million. This allowed COG to fund the acquisition of Paywise with 100% cash, funded via a debt facility together with the proceeds from EML Group.

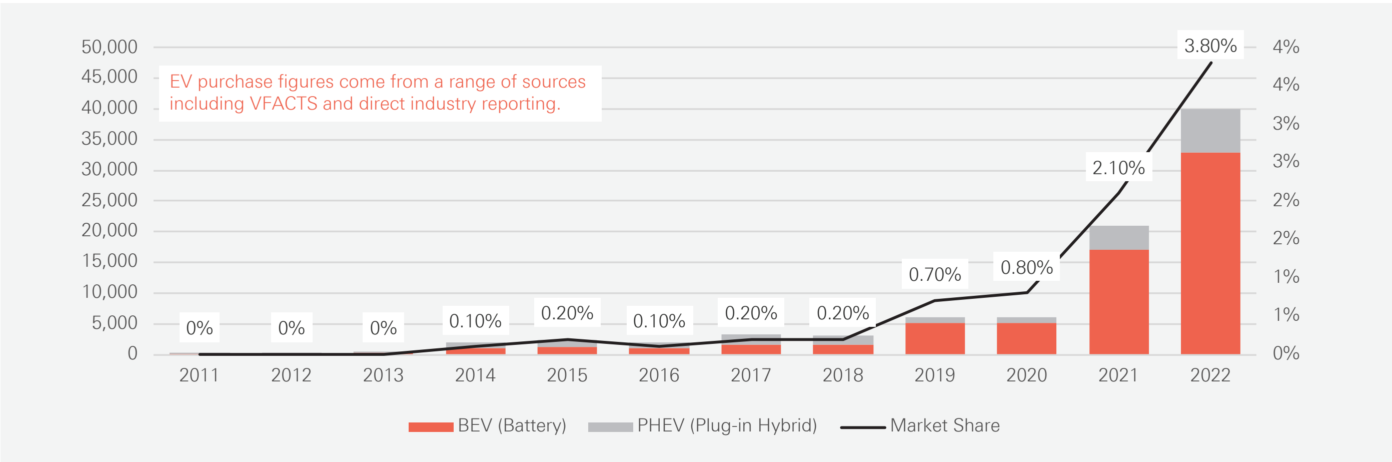
We believe this is a strategically sound acquisition for COG for several reasons which include:

- Further diversification of the group earnings which will smooth the earnings profile of the business over time i.e., the four major drivers are now finance broking & aggregation, insurance broking, novated leasing & funds management.
- As the largest finance broking group in Australia there will be numerous synergies with novated leasing i.e., buying power, funding costs and IT systems.
- Continues to move COG towards a capital light business model with a higher level of recurring revenues.
- With EML as a partner COG should be able to leverage the EML Group customer base which includes some of the largest government departments and corporations in Australia, as EML Group does not currently have novated leasing or salary packaging services to offer alongside their other services.

As we have said for many years, although COG is not solely an insurance broking business, its divisions have many of the hallmarks of an insurance broking business, yet the valuation differential is very significant. If COG can continue to grow these divisions and simplify into a capital light business model, we expect this multiple differential to close.

We estimate that on a run rate basis, earnings generated from novated leasing will represent >20% of COG group earnings. As per the chart below we believe that this earnings stream will be subject to significant earnings tailwinds over the medium term due to the ongoing transition to electronic vehicles. More recently the Federal government announced tax incentives for individuals who acquire an electric vehicle below a maximum value threshold of $84,916. These incentives have driven a surge in buyer interest for electric vehicles, and as shown in the chart below, EVs represented 3.80% of all new cars sold in CY22. Over the next few years, we expect this transition to accelerate, which in turn should drive earnings growth in COG's novated leasing division.

New EVs Purchased in Australia 2011 - 2022



Source: Electric Vehicle Council. View the report here.

MAXIPARTS

ASX: MXI

Q3 FY23 Event: HY Result

Although not the most notable event of the quarter, we felt it would be a disservice not to mention the MXI result due to the significant progress management have made which is now being reflected in the P&L. For context this was the first 'clean' set of accounts we have seen from MXI since its divestment from the old trailer manufacturing business.

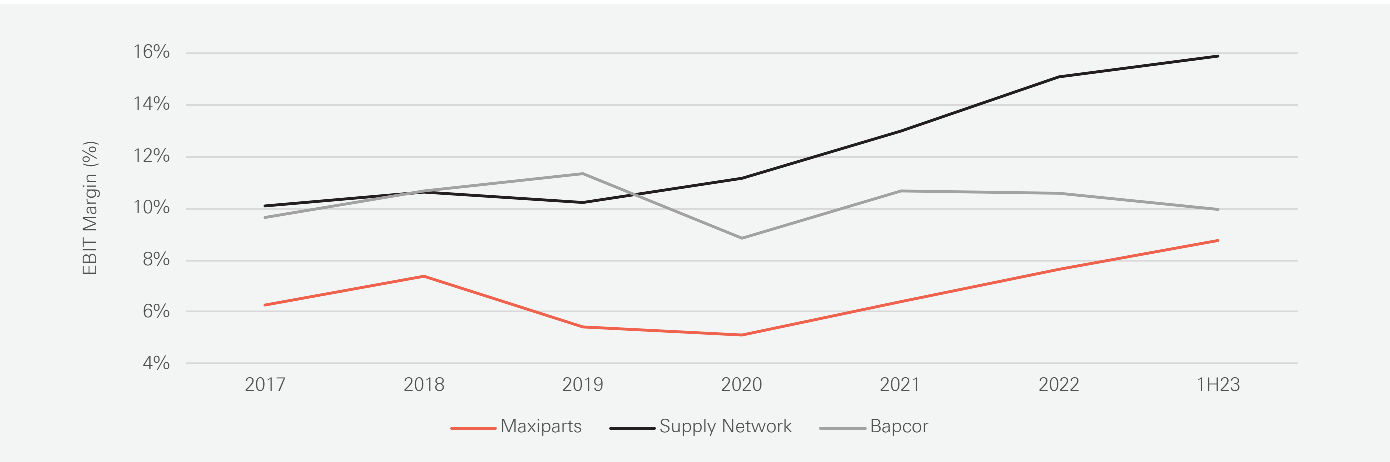
Total revenue growth for the HY was ~40% following the recent Truckzone acquisition, but pleasingly double-digit percentage organic revenue growth was still achieved for the half-year. EBITDA margins also slightly improved, despite Truckzone being a lower margin business compared to MXI at acquisition. MXI also stated that from an outlook perspective they have seen no change in the demand environment and expect core organic growth to remain at the current levels. It is worth noting that MXI also has significant tax losses which it will continue to benefit from for a number of years. As the chart below shows, from a margin perspective MXI is still very much under-earning relative to its two listed peers, namely Supply Network (ASX: SNL) and Bapcor (ASX: BAP). We expect this gap to close significantly over the next 2-3 years with MXI moving much closer towards the margin SNL is able to generate.

We believe that MXI is being valued on today's earnings which therefore assumes no margin expansion or top line revenue growth, although we would argue that the margin expansion potential is real and is already being demonstrated. We would also argue that from a revenue standpoint MXI is laying the foundation to grow consistently for many years. In the coming months MXI will open its first greenfield store in many years, which will be in South Perth. Management also remained committed to bolt-on acquisition opportunities that make strategic and financial sense, potentially in adjacent industries.

To further understand some of the changes that MXI is going through, two members of the investment team visited two MXI sites south of Brisbane (see photo on the following page) which will be part of a network consolidation strategy and were impressed by management's focus on improving operational efficiencies which should lead to margin improvement over the longer-term.

MXI may not be the most exciting business we have ever invested in, but we firmly believe it may well be one of our best performing investments over the long-term. This HY result was a clear demonstration of the potential the stand-alone MXI business has, and management are demonstrating their ability to execute on the strategy to capitalise on this.

EBIT Margin Comparison



Source – Factset


STR

BSA LIMITED

ASX: BSA

Q3 FY23 Events: Completion of APS Sale, HY Result & Sale of Fire Build QLD

Following on from what we believe will be a company changing event in the previous quarter, it was pleasing to see that the positive momentum continued to build in Q3 with three notable events occurring. The first of these was the completed sale of the APS division to CBRE. Although many may view this as a formality, in today's economic environment the completion removes any doubt and brings with it the certainty and capital that BSA requires.

Secondly, BSA announced the divestment of the Fire Build QLD division for a nominal amount. This division was a very poor contributor to earnings for the BSA group and it removes a distraction for management. This leaves just the NSW division of the Fire Build business for sale, which if able to be executed upon would remove the final poorly performing division from the group and set BSA up well for a return to overall profitable growth.

Finally, BSA released its 1H FY23 results, which essentially is just the operations of the CUI division given all the other operations have been sold or are being held for sale. Based on the clearer segment information, we can see that the CUI division has increased its profitability significantly compared to the previous corresponding period. Just as pleasing was management stating that the outlook for CUI remains positive, and that earnings should continue to improve as the operations of the business continue to scale and become more efficient.

WINGARA AG

ASX: WNR

Q3 FY23 Event: Sale of Raywood Facility

Over the past 18 months, Wingara has embarked on a strategic journey which has consisted of appointing new management, simplifying the business and returning to profitability. Significant progress was made in executing upon this strategy as WNR announced the sale of its Raywood hay processing facility which subsequently received shareholder approval late in Q3.

This facility was sold for $15 million in cash plus or minus any additional working capital adjustments. The funds from the sale will allow WNR to retire all outstanding debt, pay a special fully franked dividend to shareholders, and invest in its remaining hay processing operation to ensure it has capability to run efficiently, together with sufficient working capital to acquire the most appropriate product to process.

The operations that remain at WNR are back to the size they were when we made our original investment, and with a clean, debt-free balance sheet. WNR now has the ability to process up to 50,000 tonnes of hay, which assuming a favourable weather year and a conservative EBITDA margin per tonne, implies potential EBITDA of around $2 million p.a. If management can execute on a plan to consistently operate at this volume, then we believe it would make sense for WNR to again embark on a geographic diversification strategy to minimise the risk of weather events (such as the recent floods in Victoria) significantly affecting future earnings.

This is not the position we envisaged WNR to be in when we made our initial investment a number of years ago, but after much hard work by management and the board we believe it's a significantly better outcome than what may have eventuated under the stewardship of the previous management team and board.

SCHAFFER CORPORATION

Schaffer Corporation Limited

ASX: SFC

Q3 FY23 Event: 1H FY23 Result

Schaffer Corporation (ASX: SFC) is one of our newest investments and like many of our other investee companies we believe it is poorly understood by investors, predominantly due to the lack of stock liquidity as the founders own a large portion of the shares on issue.

In many respects we would consider SFC to be more like a small conglomerate, or even a listed investment company. Management are large shareholders in SFC and allocate capital to opportunities which they believe will generate an adequate return on capital when factoring the risk involved. Historically, the sectors in which SFC has tended to focus its investment activities have been in property, construction and manufacturing.

There are two main drivers to the earnings of SFC. The first of these is their property portfolio, which includes passive and active investments, the most significant of these being a large industrial park development in Jandakot, WA. The second driver of earnings is SFC's 83% share in an automotive leather finishing & cutting business based in Europe. For the 1H the leather division reported an NPAT of $4.8 million, compared to $7.5 million in the prior corresponding period. This division has faced numerous headwinds over the past 24 months which we believe has masked the significant progress management have made that is yet to translate into NPAT growth. These headwinds include the slow ramp-up of new car programs due to COVID-related supply chain issues, inflationary pressures especially in relation to energy prices in Europe, and adverse currency movements. In our opinion, these headwinds are transitionary and in time the auto industry dynamics will revert back to the mean.

At the same time, we expect to see an improvement in earnings due to the strategic progress that management has made over the past 24 months. The company has recently won numerous contracts, including being a large supplier for the new Range Rover Sport, a notable Mercedes model, and models from Audi and Porsche. The P&L has seen very little impact to date of these contract wins as they are yet to meaningfully commence, and when factoring in that the Range Rover Sport is one of, if not the most profitable model for the Range Rover Group, then the potential earnings uplift for SFC is significant. Over the next 36 months, we believe that the SFC Automotive Leather business has the potential to be three times more profitable than it is today due to the volume benefits mentioned above, together with the potential efficiency gains through automation etc. that we expect management to deliver. The below quote from a recent Tata Motors earnings call (Jaguar Land Rover parent company) highlights the strength of the order book and the level of demand that exists for premium cars:

> "We believe our order banks are going to stay unnaturally high, particularly on the Range Rover. But we've sold out for more than 12 months now and we're not taking new orders until 24 model year, and on the Range Rover Sport,"

Adrian Mardell, Interim CEO, Jaguar Land Rover
(Tata Motors Limited, Q3 Earnings Call, 30 Jan 2023)

INVESTMENT IN FOCUS

MOVE LOGISTICS

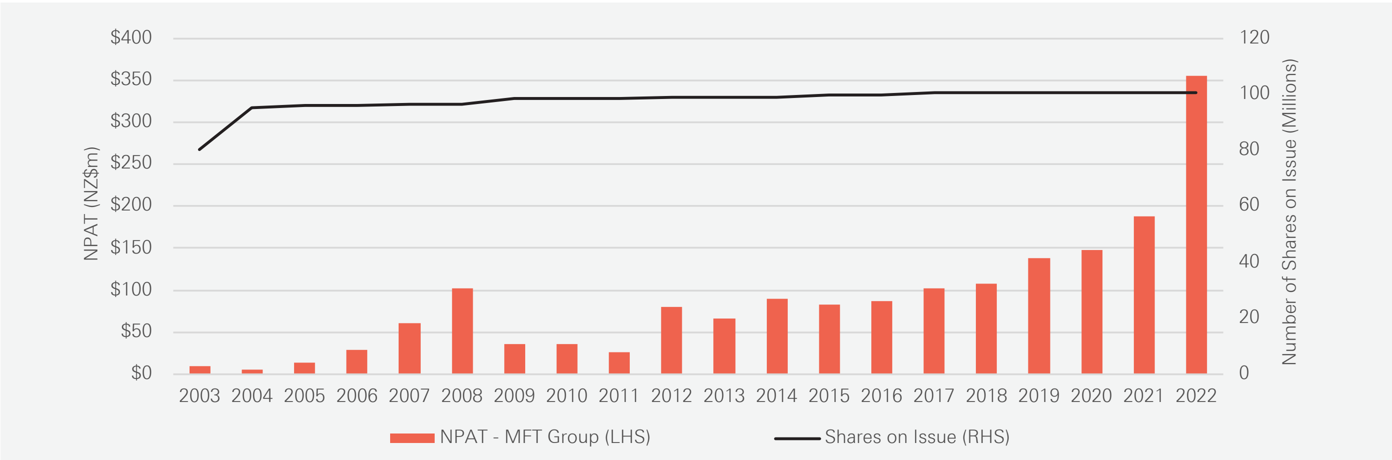
NZX/ASX: MOV

OVERVIEW

MOV is one of New Zealand's largest end-to-end logistics companies that was founded in 1869 and has all its operations within New Zealand. From the early 2000s, the former management team went on somewhat of an acquisition spree which culminated in a reverse listing in late 2017. In 2021 the entire business was rebranded MOVe Logistics Group and Chris Dunphy was appointed Executive Director. For context Chris Dunphy was a former Executive Director of Mainfreight (NZX: MFT) who led their global growth by acquisition strategy.

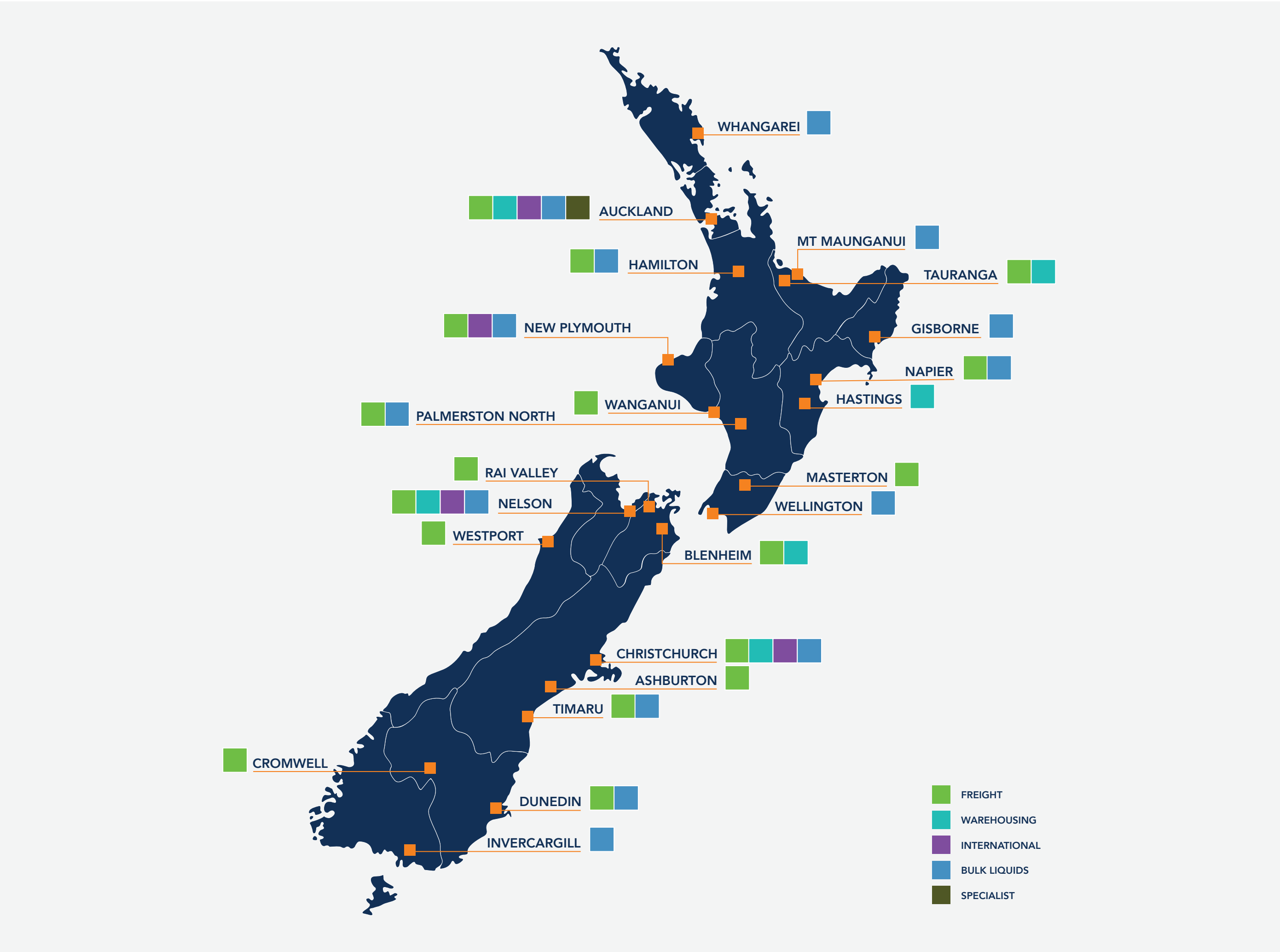
The appointment of Chris as an Executive Director marked a new era at MOV which has seen an overhaul of the management team, board and strategy. To highlight this there have been 8 new appointments to the MOV executive team of which more than 50% have had significant experience at MFT as well as Linfox and Toll Logistics. This culminated in the appointment of Craig Evans as CEO in February 2023. Craig was most recently the General Manager for MFT NZ, which remains the largest profit contributor to the MFT business. This new executive team is leading a complete overhaul of the MOV business which includes facets such as job pricing, IT systems, service offerings, fleet renewal, owner driver implementation and property asset portfolio.

20 Years of Mainfreight: Net Profit After Tax & Ordinary Shares Issued



Our investment thesis is broadly based around two key considerations that relate to the MOV business and the industry that it operates within. Firstly, MOV is operating at a profitability level well below its peers and frankly not acceptable for a business of MOV's size and capital intensity. We believe that there are some clear avenues to significantly increase profit over time, but none of these will be a 'quick fix'. However, we believe that critical to the future success of the business is that the team at MOV have a highly regarded track record of running profitable and growing logistics businesses. Secondly, the logistics industry has many similar traits to other industries that core NAOS investee companies are exposed to, the most obvious one being that the industry is littered with highly profitable businesses that were founded and are still run by people from the baby boomer era (and to a lesser extent private equity). These businesses are generally faced with the problem of having few succession options and a lack of credible acquirers of their businesses. If MOV can get their own house in order over the next 24-36 months, we would expect MOV to be a very credible option to assist these owners in realising some or all of the value in their respective companies.

The MOVe Business



Source – MOVe FY22 Annual Report

COMPETITIVE ADVANTAGE

The competitive advantage of a logistics business is in theory quite simple. In our view, it all boils down to the level of customer service you can provide to your customer base in order for them to be willing to pay a premium for the service. We feel that this service level is driven by both the culture of an organisation as well as the asset base that it operates around (i.e., location of depots, warehouses etc).

> "Any transport operator at the moment, whether you're an international freight forwarder or domestic freight forwarder, we are not dealing with customers trying to grind us into the dust with respect to rates. It's all about service; it's all about consistency of service; and it's all about reliability."
>
> Chris Dunphy, Executive Director, 1H FY22 Earnings call

The above quote is from Chris Dunphy during the 1H FY22 earnings call, which sums up the focus on service and its importance. However, in our minds, this only addresses half the equation. The other side is the culture, with a big part being the brand the staff represent. The below two pictures, taken from the FY21 Results Presentation, are a compare and contrast of the old and the new brands, which was one of the first things Chris Dunphy did after joining the board.

To be clear MOV is not currently where it needs to be on both of these measures, but we believe it has the foundations, scale and people to ensure it remedies this in the not-too-distant future.

INDUSTRY TAILWINDS

The world has changed significantly over the past 2-3 years and some of these changes have had, and will continue to have, significant ramifications on the logistics industry. The first of these changes is that consumers and businesses have an expectation of almost instantaneous goods delivery to meet their needs, regardless of where the product was made and/or where it is currently being stored. When you overlay the fact that consumers and businesses can order goods from all around the word this places a significant amount of demand on logistics networks.

The second change that has occurred is that businesses have realised that just-in-time inventory management is a strategy that can be fraught with risk and have lasting impacts on a customer's experience. Due to this we have already seen businesses undertake complete reviews of their supply chains aiming to identify areas of risk and analysing how best to mitigate them.

Going forward we believe that businesses will place more importance on their logistical partners to ensure that they can meet their customer needs without undue risk. Ultimately this should lead to higher demand for quality logistical providers who can provide a quality service and therefore charge a higher rate. In our view, what will set a best-in-class provider apart from its competitors will be variables such as systems, network of warehouses, and scale.

Logistics will always be a competitive industry but when factoring in these changing industry dynamics together with a lack of truck drivers, and ageing business owners seeking exits we feel the industry is about to experience some significant changes which will drive better returns over the long term.

Source – FY21 Results Presentation

MANAGEMENT & ALIGNMENT

As mentioned, a significant portion of our investment thesis is based around the calibre of the executives and directors who have joined the MOV business over the past 24 months. As per the table below we have highlighted 8 key MOV executives and directors who have joined the business recently together with their respective employment histories.

From an alignment perspective it's worth noting that Chris Dunphy and Mark Newman are significant shareholders together with recently appointed CEO Craig Evans who now holds 1,000,000 MOV options.

MOV Hire	MOV Role	Experience
Chris Dunphy	Executive Director	Executive Director Mainfreight and General Manager Mainfreight International
Craig Evans	CEO	Country Manager Mainfreight New Zealand 2015-2022, Mainfreight General Manager Group Supply Chain 1998-2015
Mark Newman	Independent Director	CEO Mainfreight Europe 2011-2016, General Manager Mainfreight New Zealand Transport 2001-2011
Anthony Barrett	Chief Information Officer	General Manager Toll 2016-2022, IT Manager Mainfreight 2001-2015
Mario Di Leva	Group Sales/Marketing Manager	Business Manager KiwiRail 2019-2020, Toll National Strategic BDM 2015-2019, Business Development Manager Mainfreight 1989-2000
James Waters	COO Contract Logistics	Country Manager and Managing Director Linfox 2014-2021
Scott Crampton	General Manager, Dairy	CEO Hilton Haulage Transport 2006-2022
Dale Slade	General Manager, Oceans	Commercial Line Manager in Papua New Guinea 2018-20, Manager CMA CGM 2014-18.

FREE CASH FLOW GENERATION & ROIC

We will not shy away from the fact that at this point in time, based purely on financial metrics alone, it would be hard to justify MOV as a long-term conviction buy. When you compare MOV to just about any other listed logistics company in Australia or New Zealand i.e., CTI Logistics, K&S Corporation and Lindsay Group, MOV is producing far inferior financial outcomes.

When analysing MOV's stated strategy, if executed upon successfully, we expect the business to be able to generate not only comparable financial outcomes but superior outcomes to its peers. First and foremost, profitability should increase over time as management implement their strategic initiatives such as the ones mentioned in the following section. We also expect that the size of the MOV balance sheet will reduce over time as it moves to an owner/driver model just as MFT has done, which will improve the return on invested capital profile of the business.

Interestingly, MOV is currently operating free cash flow positive which played a large part in our willingness to back this turnaround strategy. Again, as the initiatives below are implemented this should lead to improved cash conversion and a lower capex profile as assets are moved off balance sheet.

OUTLOOK & GROWTH LEVERS

With any turnaround, we have to ask ourselves does the longterm future return outweigh the risks involved, and what is the scorched earth valuation of the business, to ensure we are making an asymmetric investment decision.

As we are now in the second year of our investment in MOV we are of the view that this will be a 5+ year journey before the full potential of MOV is realised. From our perspective, a target EBIT margin of 10% is a long way off the ~1.3% that MOV achieved in its 1H FY23 results. We also believe that several MFT depots that were run by former MOV employees achieved margins closer to 10% at the NPAT level, which shows the potential of an efficient business model in this industry.

The levers that we believe will enable MOV to reach these metrics include (but are not limited to):

- Improved contract pricing structure,
- A new company wide & fit for purpose IT system,
- A greater number of owner/drivers to replace company drivers,
- Use of new transport modes such as coastal shipping and rail,
- Ensuring the property portfolio is fit for purpose.

On paper all the above may appear to be realistic and easy to implement initiatives but in reality, they are all time consuming and high-risk to implement, especially as part of a public business that is trying to maintain a short-term level of stability and profitability.

Even if we assume that it does take five years for MOV to achieve an EBIT level of $30 million then we believe an annualised share price return of >20% p.a. is more than achievable. Importantly, we do not assume any successful M&A transactions in these projections, which we believe to be a significant opportunity for MOV as we stated earlier.


NAOS
OUTLOOK

OUTLOOK

As I write this report, I am very much stating the obvious in saying that the volatile macro environment is playing havoc with investor confidence, especially for those invested in emerging companies. As such, it is easy to paint a bearish scenario for many listed companies over the short-term, and often in these times investors lose focus of the long-term earnings potential of a business as they are too concerned about short-term trading conditions.

A good example of this would be our investment in Big River Industries (ASX: BRI), which many investors expect to experience softer trading conditions over the short term due to the significant rise in interest rates. This may well be the case, but offsetting this in our view are two fundamentally key points. The first of these is the significant investment that Australia requires in areas such as infrastructure and commercial projects (e.g., Brisbane Olympic Games) but also the significant undersupply of new homes and apartments at a time when immigration levels are now above the long-term average. The second factor is that BRI commands just a ~2% share of the trade and commercial building products which in large part is still dominated by single operator businesses and presents a long runway of growth for BRI.

Q4 is generally the least eventful quarter of the financial year as many companies have reported their HY and FY results and held AGMs earlier in the financial year, when trading updates were provided. Aside from a couple of our core investments with September/March year ends which will release their half-year/full-year results mid Q4, the only other news flow we can foresee will be any trading updates provided by companies who feel their results will be materially different to the guidance they have previously provided to the market.

We remain very confident in all of our core investments across the NAOS LICs and believe they have the culture, people and balance sheets to take advantage of the positive industry fundamentals that they are exposed to.

As always, we are grateful that you have invested your capital alongside ours and we look forward to providing you with a Q4 update in mid-July.

Kindest regards,

Sebastian Evans

Managing Director and Chief Investment Officer,
NAOS Asset Management Limited

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