NAOS

NAOS QUARTERLY INVESTMENT REPORT

Q1 FY24

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

Certified B Corporation

NAOS Asset Management Limited is B Corp Certified

Q1 FY24 SUMMARY

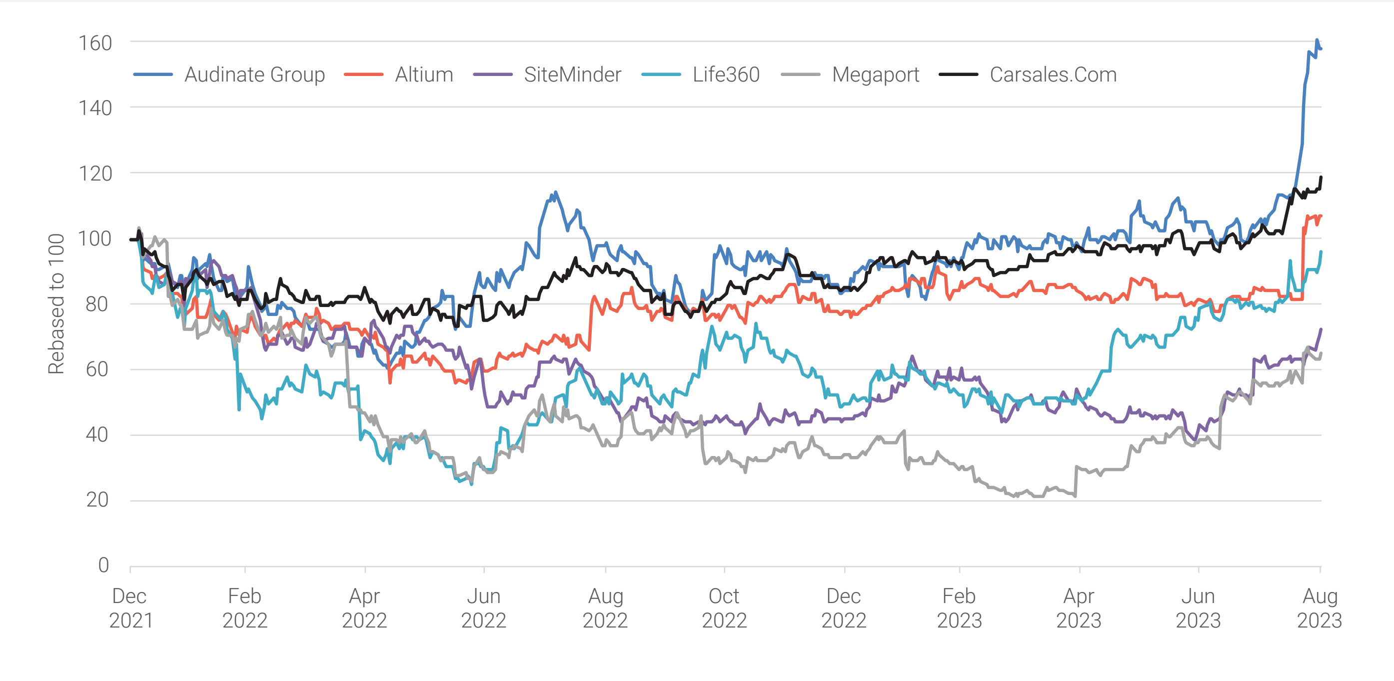
Dear Fellow Shareholder,

Another reporting season has passed and pleasingly most of the results delivered by the NAOS investee companies were in line with our expectations. This reporting season was also unsurprisingly dominated by macro variables, with companies feeling the impacts of inflation and interest rate rises. Investors continued to focus on short term variables (often outside of management's control) and how these will affect a company's earnings profile over the next 6-12 months, rather than the longer-term business strategy and the levers management can control to generate a sensible outcome for shareholders over a 3–5-year timeframe. Of the ASX-300 companies that reported, we believe ~30% beat consensus whilst ~25% missed market expectations, and looking ahead market expectations for FY24 profitability were downgraded in ~40% of all cases.

Corporate activity remained elevated in Q1 FY24 with several notable mid-cap companies receiving take-over bids, including Invocare (ASX: IVC), Estia Health (ASX: EHE) and Healthia (ASX: HLA). Interestingly, all of these businesses were acquired (or are in the process of being acquired) by private equity and all have a strategic alignment with the changing needs of an ageing demographic, highlighting the longer-term strategies private equity firms are willing to take relative to their publicly listed counterparts. In our view, it is clear that public market investors are not pricing businesses efficiently and placing too much emphasis on short term variables when valuing a business.

As we wrote in our FY23 annual letter to shareholders, technology businesses recorded significant share price gains throughout 2H FY23 following their sharp drawdown in CY22. This momentum continued through reporting season and is illustrated in the table below, which shows the share price performance of a number of technology stocks from the start of CY22 through to the end of August.

Technology Stocks (Price Performance)



Source: FactSet

As is customary with reporting season, but particularly in FY23, the focus was very much on the year ahead and the ability of management teams to execute on strategy. In our view, companies conveyed the following key themes in their outlook statements:

HIGHER COSTS

Companies will undoubtedly be grappling with higher cost bases in FY24 mainly due to the annualised impact of cost increases incurred in FY23. These costs encompass various areas, including employee costs, energy costs, borrowing costs, finance leases or even travel expenditure and as such expected cost bases in FY24 will be higher than in FY23. This will need to be offset with revenue growth and/or gross margin improvement. Interestingly, several companies expected cost increases to slow in FY24 or even plateau which could paint a more productive backdrop for profit margins in FY25/FY26.

END OF PRICE INFLATION

Business commentary indicates a more subdued level of price rises for products and services in FY24, which is fundamentally the result of the materially higher price rises faced in FY23. In some cases, such as building products and new and used cars, it may not be unreasonable to expect moderate price deflation, albeit from elevated levels.

REVENUE VISIBILITY

When questioned about revenue visibility, many CEOs responded with phrases like "I am not an economist", suggesting they have little insight into what the future holds. In our view, this uncertainty resulted in a majority of businesses not providing quantitative guidance, and instead referring to qualitative statements with an expectation of trading updates at the time of their Annual General Meetings (AGMs). Frankly we were left a little bemused by the variability of comments made in regard to the demand environment, such as continued strength in the automotive space and leisure travel, while consumers are being more price conscious in areas such as consumer staples. Regardless of the short-term concerns, many CEOs remained optimistic about the longer-term fundamentals, particularly in regard to housing, infrastructure, renewable energy and services for an ageing demographic. For the few companies that provided commentary around trading in July and August, their comments showed that demand has remained resilient so far.

SUPPLY CHAIN MANAGEMENT

Two years ago, many businesses faced difficulties accessing the necessary products for their operations in a timely manner. Today, it appears the situation has reversed, with supply chains, in most cases, back (or close) to normal. Consequently, businesses are having to adjust their processes to ensure they have adequate inventory at a manageable cost. A number of businesses made mention of a deliberate effort to move stock which had been ordered many months ago when the supply demand dynamics were different, and prices were much higher. However, some companies were slow to react and have been left with no choice but to discount aggressively and sell inventory at a loss, or write down carrying values. Looking ahead, it has already become apparent that in the discretionary space, purchase orders for the Christmas period will significantly decrease due to high inventory levels together with a more subdued demand environment. One positive outcome from this situation is the significant decrease in the cost of freight & logistics. This was especially apparent in the Q1 FY24 trading update for Mainfreight (NZE: MFT), where its Air & Oceans division reported falls in revenue and profit before tax (vs. PCP) of -41% and -54% respectively.

INVESTMENT PORTFOLIO PERFORMANCE SUMMARY

Investment Portfolio	Q1 FY24 Performance	1 Year Performance	3 Year Performance (p.a.)	5 Year Performance (p.a.)	Inception Performance (p.a.)
NCC Investment Portfolio Performance*	-4.60%	-5.15%	+2.79%	+0.10%	+8.30%
S&P/ASX Small Ordinaries Accumulation Index	-1.94%	+6.85%	+2.57%	+1.63%	+4.38%
NAC Investment Portfolio Performance*	-2.57%	+12.56%	+3.46%	+6.76%	+10.53%
S&P/ASX 300 Industrials Accumulation Index	-1.05%	+10.93%	+8.56%	+5.08%	+6.3%
NSC Investment Portfolio Performance*	-4.41%	-3.31%	+8.19%	+2.92%	+2.25%
S&P/ASX Small Ordinaries Accumulation Index	-1.94%	+6.85%	+2.57%	+1.63%	+2.94%

*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 30 September 2023. NAC Benchmark= S&P/ASX 300 Industrials Accumulation Index, NCC & NSC Benchmark= S&P/ASX Small Ordinaries Accumulation Index

NAOS CORE INVESTMENTS

	ASX Code	NAOS % Ownership (<5%, 5-20% or >20%)	Market Cap (as at 30 September 2023)
Big River Industries	ASX: BRI	>20%	$181 million

Big River Industries Limited (BRI) is a leading manufacturer and distributor of value-added timber and building material products in Australia and New Zealand. BRI has gained scale in recent years through the acquisition of bolt-on businesses to diversify its product offering and expand its geographical network, which now sits at 26 sites. BRI operates in the commercial sector, with customers using BRI products in real estate developments (detached and multi-residential), commercial construction projects and civil construction, among others. BRI has over 9,000 active trading accounts, serviced by ~640 staff members. BRI achieved $450 million in revenue in FY23.

BSA	ASX: BSA	>20%	$43 million

BSA (BSA) is a technical services business, with a national network of +250 skilled employees. The core business of BSA manages close to 4,000 jobs daily across many industries including energy, EVs and most notably, across multiple technologies within the telecommunications industry. BSA's client base includes National Broadband Network (NBN), Vector, Intellihub and Foxtel.

COG Financial Services	ASX: COG	>20%	$255 million

COG Financial Services (COG) is Australia's leading aggregator of finance brokers and equipment leasing services to small and medium-sized enterprises (SMEs). COG's operations are spread across three complementary business divisions: Finance Broking & Aggregation (FB&A), Lending & Funds Management, and Novated Leasing, all of which service the financial needs of the SMEs nationwide. As at the end of FY23, COG had an ~21% market share of the Australian Asset Finance Broking market, with the COG network financing $7.7bn in assets for SMEs in FY23. COG has been highly acquisitive in recent years, acquiring finance brokers, insurance brokers, as well as fund management and novated leasing businesses.

Saunders International	ASX: SND	>20%	$110 million

Saunders International (SND) has expertise in engineering and construction projects, having worked across Australia for over 70 years. Today, SND has over 400 employees, who work on projects in the Energy, Water, Power, Defence, Resource and Infrastructure sectors. The projects SND execute are of critical importance to their clients in Federal/State Governments and the Private Sector. Clients of SND include Western Sydney Airport, NSW Government (Bridges Program), BP and the Australian Defence Force.

MaxiPARTS	ASX: MXI	>20%	$135 million

MaxiPARTS (MXI) is a supplier of commercial truck and trailer aftermarket parts to the road transportation industry. In operation for over 30 years, MXI is one of the largest operators in Australia, with a unified support and distribution network providing over 50,000 different parts across 27 sites nationwide.

	ASX Code	NAOS % Ownership (<5%, 5-20% or >20%)	Market Cap (as at 30 September 2023)
MOVE Logistics	ASX/NZX: MOV	5-20%	$84 million (NZX)

MOVE Logistics (MOV) is one of the largest freight and logistics providers in New Zealand. It has a large network of 41 branches across the two main islands of New Zealand, with capability to serve more than 3,500 customers. Originally listed on the New Zealand stock exchange, the business dual listed on the ASX in July 2022.

Urbanise.com	ASX: UBN	>20%	$27 million

Urbanise.com (UBN) is an Australian headquartered cloud-based software business, providing solutions for both the Strata Management industry as well as the Facilities Management industry in the Asia Pacific and the Middle East regions. The Urbanise Strata Platform is a market leading accounting & administration software system used by strata managers across ~700,000 individual strata lots., The Urbanise Facilities Management Platform is used to aid the maintenance of property assets and supervision of contractors across various sectors including aged care, retail, commercial and essential infrastructure.

Gentrack Group	ASX: GTK	<5%	$487 million

Gentrack (GTK) is a global software specialist, operating in 6 countries, whose solutions support energy utilities, water companies and airports. GTK's customer and billing-focused products are mission-critical for utility-retailing companies across the UK, Australia, New Zealand and Singapore. GTK's Veovo airport operations software is used by more than 120 airports and transport authorities globally.

Dropsuite	ASX: DSE	<5%	$171 million

Dropsuite (DSE) is a partner-centric cloud software platform enabling businesses and organisations globally to backup, archive, recover and protect important business information. DSE helps to protect over 1 million users globally from data loss on platforms such as Microsoft 365 and Google Workspace.

Ordermentum	Unlisted	Undisclosed	Undisclosed

Ordermentum is a two-sided ordering, payments, and insights platform widely used in the hospitality industry. The B2B ordering & payments platform connects hospitality venues (including cafes, restaurants, clubs and pubs) across Australia with suppliers, helping to improve business efficiencies, grow sales and drive profitability for both suppliers and venues.

MitchCap	Unlisted	Undisclosed	Undisclosed

MitchCap is a provider of Distribution Floorplan Finance to Australian and New Zealand dealerships within the caravan, marine, agricultural and bicycle industries. Founded in 2019, MitchCap solves a capital intensive pain point for equipment dealerships through financial solutions that can improve dealer profitability and capital efficiency whilst also lowering risk for equipment manufacturers.

NOTABLE INVESTEE COMPANY UPDATES

MOVE LOGISTICS

ASX: MOV

FY23 Result & Operation Blueprint

The financial year results for MOV were always going to be eagerly awaited by the NAOS investment team, not for the financial performance but for any granular update provided by the new CEO, Craig Evans. From a financial perspective, MOV's results were as expected for a company in 'turnaround phase' that is experiencing challenging macro conditions. FY23 revenue, EBIT, NPAT and free cash flow all went backwards compared to FY22. However, beneath the surface we believe we are starting to see the foundations of a business that will be significantly more profitable in the years ahead. The following points support our enthusiasm for MOV:

BUILDING OUT OF THE MOV TEAM CONTINUES

With many appointments made in the executive team prior to the appointment of Craig Evans as CEO, it was always going to be interesting to see if wholesale changes were going to be made. While there hasn't been wholesale changes, there were a few adjustments, with a couple of notable additions to the team. These new hires come with significant industry experience from the likes of Mainfreight (NZE: MFT).

The first of these appointments was Rachel Hustler as GM People & Culture. Rachel spent almost 19 years at MFT where she was most recently the National Training, Development & HR Manager, and held a leadership role in Mainfreight New Zealand. As Craig Evans spent ~35 years in MFT New Zealand we believe he would have firsthand experience of how Rachel was able to execute on important initiatives such as a graduate training program, implementing change management strategies and facilitating numerous leadership courses. All of the above are imperative for MOV's ability to recruit, develop and retain top talent in the logistics industry, ultimately contributing to the desired organisational culture that Craig Evans is trying to foster and achieve.

Secondly, Ricky Clark was appointed as National Sales Manager of MOV. Prior to 2019, Ricky spent ~7 years at MFT New Zealand where he progressed to Linehaul Operations Manager. Whilst no single appointment will change the entire MOV business, we suspect there has been significant staff turnover at MOV over the past 24 months and with most (if not all) of the executive team coming from businesses with a proven focus on culture, this collective experience should assist MOV in accomplishing its goals with regard to cultural change over time.

PROJECT BLUEPRINT & STRATEGY FOR GROWTH

We eagerly awaited any commentary that MOV would provide around their strategy to return the business to growth and profitability and a reasonable amount of information was provided in the form of 'Project Blueprint'. Essentially this program is split into two main parts, the first driving an immediate benefit by reshaping and strengthening the business, while the second focuses on driving organic growth, which should lead to both shorter & medium-term benefits. Of note was the relatively near term 12–18-month timeline that the CEO has given himself and the MOV team to implement this strategy.

The first part of the strategy aligns with our initial investment thesis on MOV. As per the table on the next page, MOV has the size and scale of many comparable businesses but from a margin perspective it has been a serial underperformer. We believe that this part of Project Blueprint will go some way to addressing this margin deficit. New initiatives include a rationalisation and renewal program of the truck fleet, ensuring an adequate level of owner drivers on optimal routes, successful implementation of new IT software, an overhauled pricing structure and improved processes with more accountability and measurability, particularly at the branch level.

MOV Comparable Companies FY23 Results

	Revenue ($m)	EBITDA ($m)	EBITDA Margin %	NPAT ($m)	NPAT Margin %
Mainfreight Limited (NZE: MFT)	$5,675.7	$851.0	14.99%	$426.5	7.51%
CTI Logistics (ASX: CLX)	$302.0	$36.6	12.12%	$16.4	5.43%
Lindsay Australia (ASX: LAU)	$676.2	$90.3	13.35%	$34.5	5.10%
K & S Corporation (ASX: KSC)	$848.9	$90.1	10.62%	$29.3	3.45%
Move Logistics Group (ASX: MOV)	$347.7	$47.4	13.62%	-$5.8	-1.68%

Source – S&P Capital IQ, NAOS

The second phase of the strategy focusses on growing the business organically in a profitable manner, which has not been achieved by MOV since listing. In our view the three core pillars of this strategy will be:

1) building out a less than truck load (LCL) offering;
2) developing a capable sales function; and
3) collaboration with one or two other logistics companies (ideally in Australia) to assist in both network utilisation and growing the nascent oceans offering.

It is still early days but as we have said previously, we believe the 'green shoots' are evident and potentially we are seeing early signs of financial improvement as witnessed by the 1.50% EBITDA margin improvement in the freight division in 2H FY23 vs 1H FY23, despite the ~19% revenue decline over the same period. Admittedly, it's only one metric but hopefully the start of something much more significant.

SAUNDERS INTERNATIONAL

SAUNDERS INTERNATIONAL

ASX: SND

FY23 Result & Project Caymus Closure

FY23 was always going to be a transformational year for SND with an elevated level of execution risk given the growth rate of the business over the last three years. There was particular attention on the FY23 result due to the termination by convenience in April of SND's largest ever contract, the $165 million Project Caymus in the Northern Territory.

Investors were looking for clarity to understand the following:

- SND's ability to manage margin on such a large project when compared to anything historically completed,
- any payment issues and subsequent cash flow discrepancies following the termination prior to completion and
- SND's ability to maintain an adequate orderbook in the face of the completed Project Caymus.

From a margin perspective SND was able to deliver a healthy EBIT margin of 7.2% which we believe is a commendable result in the face of the significant top line growth SND has experienced, particularly when taking into account weather-related issues and cost inflation. Relative to its peers, this places SND in the top quartile for EBIT margins. It is also worth noting that the Civilbuild business, which represents circa $30 million of revenue, did not contribute to profitability due to the aforementioned issues. Excluding this $30 million revenue, the group margin would increase to 8.50% based on the $14.4 million EBIT delivered by the rest of the business.

The major negative takeaway from the FY23 result was the cashflow conversion which saw SND report a ~-$24 million reduction in cash and cash equivalents due to the poor cashflow from operating activities. On closer inspection this was driven by the large increase in contract assets of ~$25 million, meaning SND has completed works recognised as revenue but payment has not yet been received. The Company stated that a large portion of this related to Project Caymus. In early October SND released an announcement stating that Project Caymus been closed off with its former customer and that the cash balance at 10 October 2023 stood at $39 million, a significant improvement to the $13 million held as at 30 June 2023.

As with any contracting business, the orderbook falls away as revenue is recognised through completion of projects, and therefore new project wins are required at the same rate (or ideally faster). SND was able to grow their orderbook by $7 million YOY even though it worked through its entire orderbook over FY23 (with one contract making up ~40-50% of the entire book). This is a commendable outcome for the SND management team and highlights how they have been able to diversify the business into new revenue streams as well as win a number of contracts of significant scale, such as the $44 million contract with Quantem Energy, the second largest contract in SND's long history.

FY23 will go down as a year where SND took a major step in scaling and diversifying the business into new adjacent markets. Whilst no quantitative guidance was provided by management, the industry tailwinds for SND remain highly supportive of the business over the short to medium term. With over 400 employees, compared to just 200 over 3 years ago, the internal capability is significant, and we expect to see further notable organic and inorganic wins going forward.

In terms of peer comparison, Monadelphous (ASX: MND) is a great example of a successful contractor who achieved substantial scale. MND had little to no earnings in 1987 when John Rubino and his fellow partners were brought in to turn the business around. Through a combination of margin discipline, avoidance of contracts that could jeopardise the balance sheet, and minimal dilutive capital raisings, MND achieved impressive scale that places it amongst one of the largest listed contractors on the ASX. Over the last twenty years, MND has been able to grow its revenue base tenfold (at a ~11% CAGR), to close to $2 billion in turnover today (currently at a 3% NPAT margin). Impressively, this scale has been achieved through internal organic growth, rather than dilutive capital raises that can destroy shareholder value and earnings per share. As a result, the total shareholder return since IPO has far surpassed the result of the wider index, with MND returning a 24% CAGR since inception versus 9% for the S&P/ASX All Ordinaries Accumulation Index over the same time period. This result exceeds some of the strongest performing listed businesses, with leading distributor Reece Limited (ASX: REH) returning 19% per annum since listing (total shareholder return) and even "category killer" JB Hi-Fi Limited (ASX: JBH), which has returned 22% p.a. Through careful management, MND took advantage of its capital light model and achieved outstanding results for its shareholders.

ORDERMENTUM PTY LTD

Ordermentum

UNLISTED

Acquisition of Foodbomb

In last quarter's investment report, we provided a detailed update on our other private investment, MitchCap Pty Ltd, which completed a substantial funding round worth close to $200 million during the quarter. This quarter we are providing an update on the other private investment held within NCC, being Ordermentum. It has been a highly eventful period for Ordermentum as they successfully acquired wholesale food marketplace Foodbomb, whilst completing a financing round of ~$16 million at a higher valuation than circa 16 months ago when we made our initial investment.

Ordermentum is an order management technology platform that connects hospitality venues (cafes, restaurants, etc.) with wholesale food and beverage suppliers from whom they purchase their goods. Ordermentum has ~40,000 venues and ~850 suppliers, many of which sell coffee, baked goods and milk. This forms the core offering of Ordermentum and has seen the business grow significantly over the past 3-5 years. The payment of these orders between venues and suppliers can be facilitated by Ordermentum to further streamline transactions, remove payment delays and reduce errors. The proportion of total transactions being paid for 'on platform' is increasing significantly.

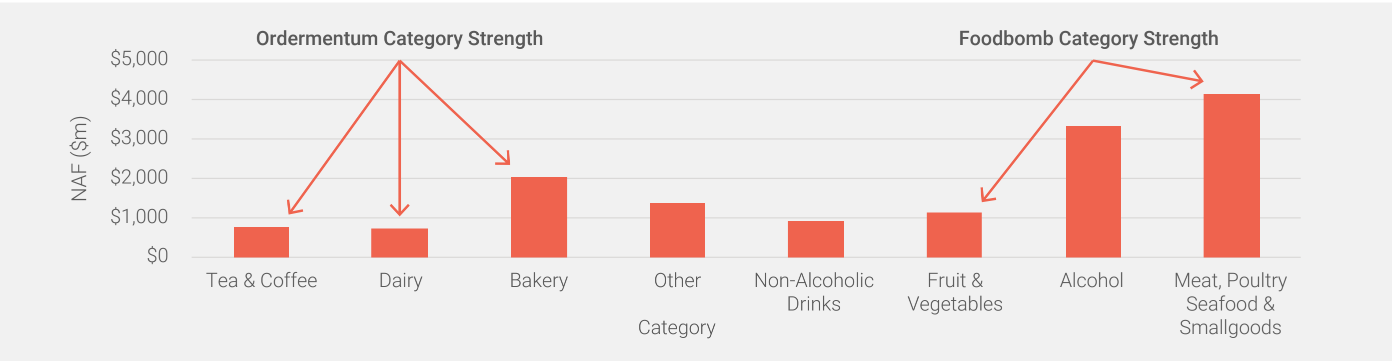
Over the past 12-24 months Ordermentum has been building out their platform with an adjacent offering. This adjacency is in essence a marketplace that showcases an array of food and beverage suppliers to potential venue customers. It allows choice for venues who are looking to change supplier and/or add further suppliers/produce to their service offering such as suitable new bakery suppliers for a specific café for example.

From a supplier's perspective, Ordermentum acts like a salesperson (or multiple salespeople) by showcasing their brand & produce to a far greater potential pool of venue customers, some of whom may have previously been unobtainable. This in turn can drive sales growth for their own businesses. For the venues, it saves them time and effort in understanding which suppliers offer what products, provides access to new suppliers, and allows for price comparison as well also other variables such as delivery times/days etc.

One of the areas where Ordermentum has a significant growth opportunity is the breadth and depth of its supplier category offering. It has a strong pedigree in categories such as coffee, dairy & baked goods but it does not have the same pedigree in 'fresh' produce categories (fruit & vegetables, meat, poultry, etc.). This in turn forces venues to look elsewhere for these fresh categories, meaning Ordermentum isn't a 'one stop shop' for all their ordering needs. This is where the acquisition of Foodbomb makes a significant amount of strategic sense.

The Foodbomb platform is entirely a marketplace offering with a particular focus on fresh produce via suppliers such as national operator Foodlink. The acquisition of Foodbomb will provide Ordermentum with an expanded supplier base with a fresh produce focus, which is outlined in the below chart. These suppliers are well versed in transacting with customers via a marketplace style offering. Many of these customers are large hospitality groups who require large volumes of fresh produce. We believe that as a supplier you would be willing to pay away more of your margin to a platform that not only saves your business time and creates efficiency but also acts as a sales engine and boosts revenue. Therefore, if Ordermentum can effectively combine & scale their own marketplace offering with Foodbomb, the effect on its own revenue line will be significant.

Total Food & Beverage Gross Merchandise Value by Hospitality Venues (exQSR)



Source: Ordermentum, NAOS

COG FINANCIAL SERVICES

ASX: COG

FY23 Result & Acquisition of McMillan Shakespeare Aggregation.

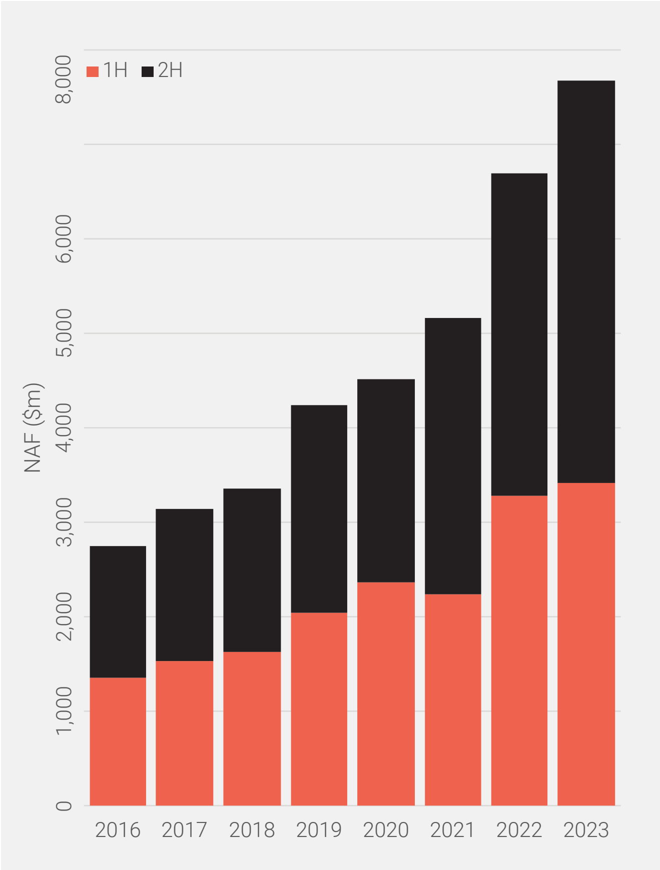
In our view, FY23 was marred by the performance of Earlypay (ASX: EPY), and the subsequent equity accounted loss COG recognised in its profit and loss statement due to their ~20% holding/investment in EPY. As a result, COG reported earnings per share prior to amortisation (EPSA) of 12.55cps, down from 13.87cps in the prior year. From a divisional perspective the core divisions of Finance Broking & Aggregation (FB&A) as well as Funds Management (FM) performed well. The FB&A division saw finance volumes increase to $7.7 billion (the amount of loans aggregated via COG controlled platforms, also known as net asset finance (NAF) which resulted in NPATA growth of ~12%. The funds management division saw NPAT fall by ~13%, however we would argue the quality of the result was much improved as the TL Rentals loan book, which is in 'run off', made a substantially smaller contribution than in the previous year. In addition, there were a number of one-off expenses taken through the P&L, as COG controlled subsidiary Westlawn Group expensed a number of costs in FY23 relating to the establishment of their first warehouse financing facility with a big-4 bank.

COG also provided improved disclosure on its '3rd division', the novated leasing and salary packaging business operating under the brand name Fleet Network. In April 2023 COG settled on the acquisition of WA-based Paywise, a salary packaging business purchased for $30 million at a 6 times EBITDA multiple (meaning the business generates $5 million EBITDA or theoretically $3 million of NPATA). COG disclosed that the revenue of Paywise had increased by 40% from Q1 FY23 to Q4 FY23. As a relatively small player in the market when compared to some listed peers, if Paywise is able to maintain this growth rate into FY24 then it could potentially result in an increase of ~$2 million in NPATA for COG, which would represent an 8% increase on the groups reported FY23 NPATA figure.

Finally, COG disclosed that it had acquired the finance aggregation businesses United Financial Services (UFS) and National Finance Choice (NFC) from McMillan Shakespeare (ASX: MMS) at the end of July. These businesses have been non-core to MMS for some time so it made logical sense for COG to acquire them, assuming the financial terms were sound. These acquisitions have the potential to take COG's NAF to ~$9 billion on an annualised basis, which would make COG the largest asset finance aggregation platform in Australia by far. As the industry continues to consolidate with players such as COG, Australian Finance Group (ASX: AFG) and Connective leading the way, the increased scale will benefit COG and enable it to continue to reinvest in its service offerings to maintain its competitive moat, solidifying its position in the market.

Looking forward, we will be hoping for a much cleaner and therefore higher growth year from a profitability perspective. From a starting base of $23.7 million, it is conceivable to see COG achieving NPATA of $30 million for FY24. EPY have already issued guidance of "exceeding FY23 pro-forma NPAT" which, if taken at face value, would represent a $3 million NPATA benefit for COG. Although no financials were given for the recent UFC and NFS acquisitions, we would assume a minimum $1 million of NPATA. Furthermore, COG will benefit from an extra 10 months of the Paywise acquisition, which in our view should add at least $2 million of NPATA. With COG still trading at a discount compared to its peers, the forthcoming Q1 trading update should hopefully allay any concerns about COG's growth trajectory.

Finance Broking & Aggregation - Net Asset Finance (NAF)



Source – COG Financial Services

BTC HEALTH

ASX: BTC

Placement to Strategic Investors

After what can only be described as a tumultuous 3-year period for BTC, the business had some positive news flow and what appears to be the start of a new chapter for BTC. The business welcomed three new strategic investors (all of which are related) onto the register, collectively representing a 15% stake in the Company, along with the appointment of a related party as the new Head of Finance for BTC. The three businesses all operate within the medical device space and either design, manufacture and distribute their own products or distribute third-party products. With these firms as shareholders in BTC, it opens up opportunities for BTC to partner with them and identify and commercialise medical devices into the Australian market via a distribution agreement with BTC. In our view, the major shortcoming of BTC to date has been its inability to scale either via acquisition or via organic opportunities such as licensing other medical products.

The medical device space is dominated by large players such as EBOS Group (ASX: EBO), and historically it has been challenging for BTC to convince vendors of businesses or owners of medical devices who require a distribution partner that BTC is the low-risk choice. This deal provides BTC access to numerous medical devices with no upfront cost, an aligned partner via equity ownership, and a royalty agreement that converts to BTC shares. If BTC can prove to the market that a number of these devices can penetrate the Australian market and drive profitability for BTC, it will go a long way to restoring confidence in management and the business. We believe this is a sound first step, and working with a strategic partner possessing significant industry experience means the future looks significantly brighter for BTC.

BTC also announced two commercial deals in mid-September. The first was the acquisition of the exclusive rights to distribute neuro-spinal IZI Medical and Ilumark medical products (some of their needle products are pictured on the right). While a small deal in absolute terms, BTC's Executive Chairman Richard Treagus noted the deal as an immediate profit contributor, a decisive step into a new product vertical and adds expertise through which BTC can continue to expand. The second was an exclusive sales and distribution agreement for Rhythm infusion pumps in Australia (displayed on the right). This appears to be an important deal in replacing the Ambit infusion pumps agreement which discontinues in FY24.

Quick-Core Biopsy Needle

Quick Core Biopsy Needle Set


NAOS
INVESTMENT
IN FOCUS

SAUNDERS INTERNATIONAL

SAUNDERS INTERNATIONAL

ASX: SND

HISTORY

Saunders International (ASX: SND) is a contracting business founded in 1951 with its main premises in Bankstown, Sydney. For nearly seven decades, the core of SND's business has centred around its expertise in constructing large liquid storage tanks. Over the years SND has worked with many large energy companies such as BP (as shown in the below news article from 1966), Shell and Caltex, starting in the 1960s and continuing until the present day. SND listed in 2007 during the resources boom and continued with its strategy of servicing clients, such as the ones mentioned above, by providing construction and maintenance services aligned with its core capability.

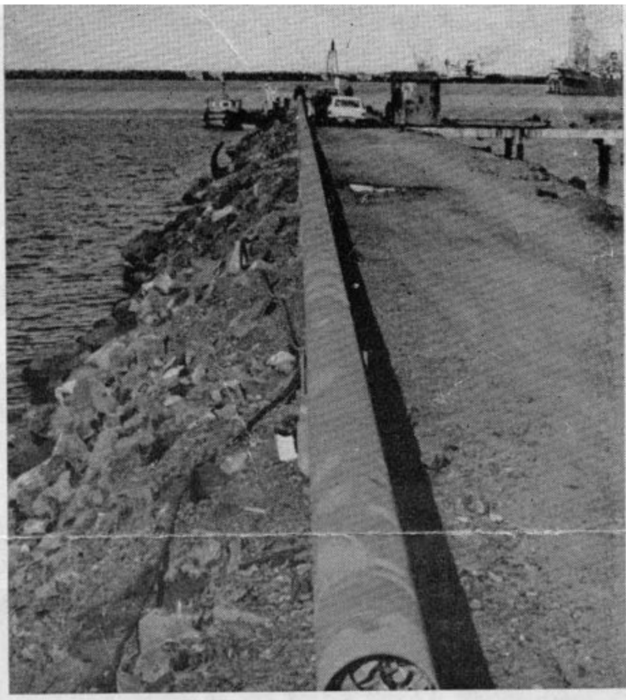
Current CEO & Managing Director Mark Benson was brought into his current role in late 2015, taking over from Tim Burnett, who was CEO from 1990 and has been on the SND board since 1990. In our opinion the appointment of Mark Benson marked a new era in SND's long history and set the business on course not only to scale but also to diversify into new industry segments with long-term growth potential (such as renewable energy), in addition to developing a more recurring revenue profile.

Underwater Pipeline at Port Kembla

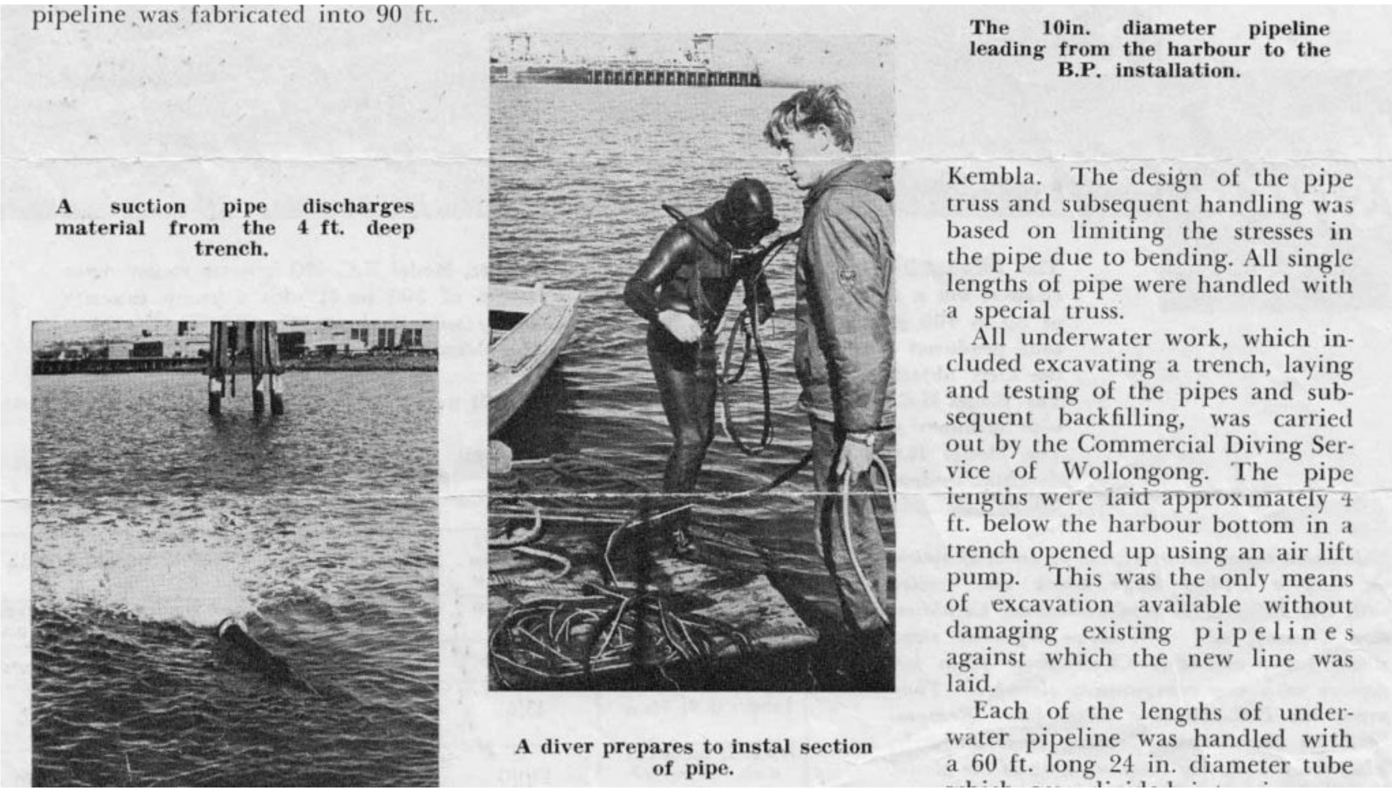
A new 10in. wharfline has recently been completed by V. G. Saunders Pty. Limited for BP Australia Limited at its Port Kembla installation. The line runs for a distance of 4,700 ft. from the installation to the tanker mooring berth on the north side of the harbour.

THE new pipeline replaces a previous 8in. line. The whole of the pipeline was cement lined, the underwater and underground sections by spin lining, the remainder by the "in situ" method of lining. The underwater section of the line has a Polytec coating and 1½in. of gunite for mechanical protection and dead weight.

The underwater section of the pipeline was fabricated into 90 ft.



The 10in. diameter pipeline leading from the harbour to the B.P. installation.



pipeline was fabricated into 90 ft.

A suction pipe discharges material from the 4 ft. deep trench.

A diver prepares to instal section of pipe.

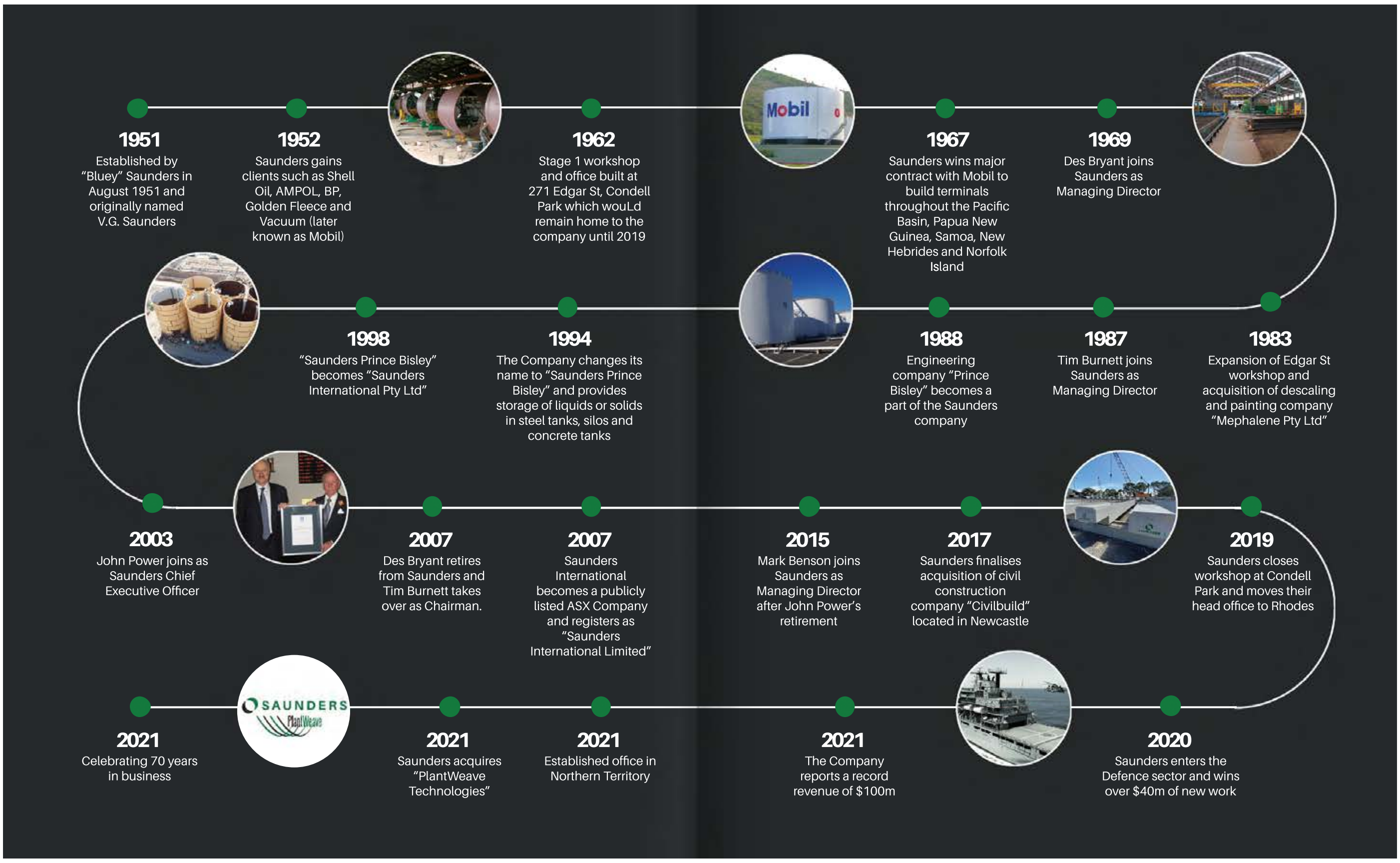
The 10in. diameter pipeline leading from the harbour to the B.P. installation.

Kembla. The design of the pipe truss and subsequent handling was based on limiting the stresses in the pipe due to bending. All single lengths of pipe were handled with a special truss.

All underwater work, which included excavating a trench, laying and testing of the pipes and subsequent backfilling, was carried out by the Commercial Diving Service of Wollongong. The pipe lengths were laid approximately 4 ft. below the harbour bottom in a trench opened up using an air lift pump. This was the only means of excavation available without damaging existing pipelines against which the new line was laid.

Each of the lengths of underwater pipeline was handled with a 60 ft. long 24 in. diameter tube

Our History



Source: Saunders International 2021 Annual Report

THE TRANSFORMATION

When Mark Benson stepped into the role of CEO, he initiated what we would describe as the following three-stage process:

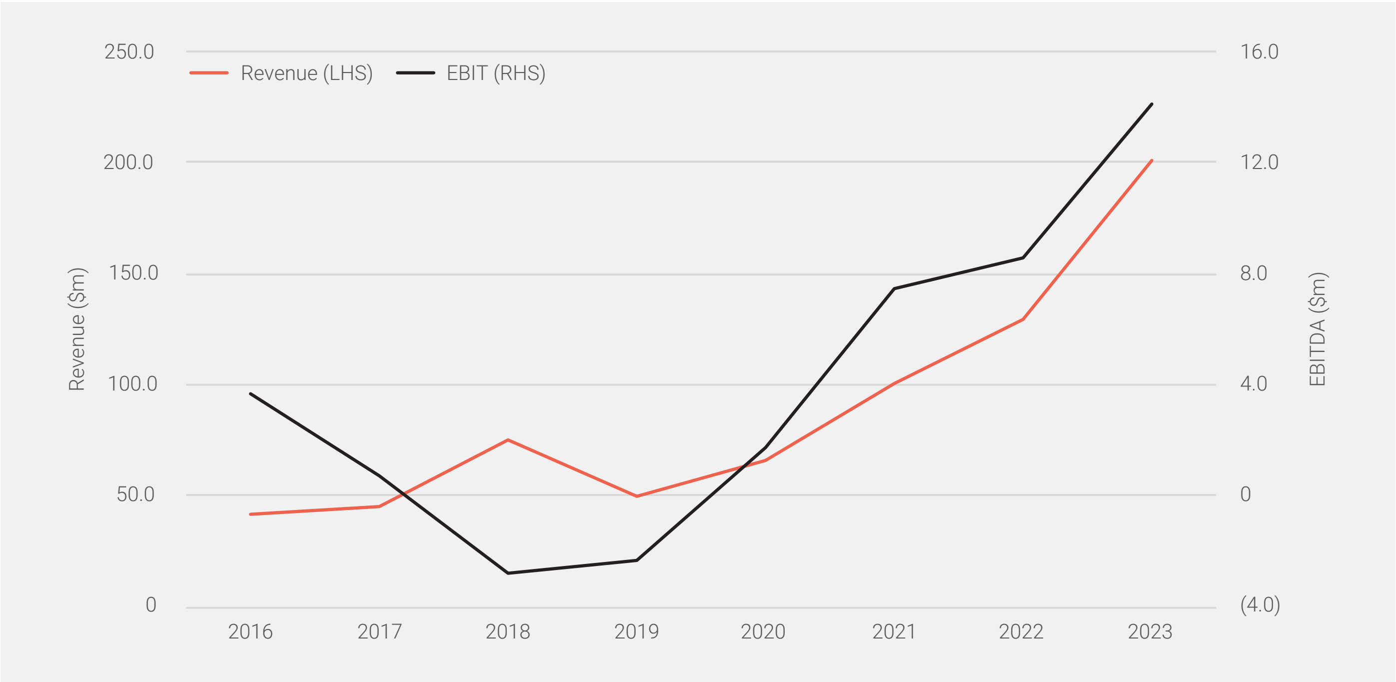
Flexible Cost Base, Culture & People, Win Fair Share

SND had been a profitable business since listing but one which had a niche focus, heavily reliant on securing large storage tank-related projects at fair margins. However, the changing business landscape required SND to adapt accordingly in order to prosper. Historically, SND completed much of the tank manufacturing work at their Bankstown headquarters but such a facility came with a significant fixed cost base and capex requirements to maintain the facility. This facility was closed and sold and SND looked to partner with large multinational companies who could fabricate the materials that SND required on a more cost-effective basis without compromising quality.

To minimise execution risk and enhance SND's capacity to negotiate fair terms with clients, a substantial overhaul of the SND team was undertaken. This included key additions such as a Commercial Manager, CFO, Operations Manager, and a highly regarded COO.

With the team in place, SND went on to win its fair share of work within its historical niche market focus that the business had historically been capable of, yet not always in a consistent and manner. From 2016 to 2021 this saw revenue increase from $41 million to $101 million and EBIT grow from $3 million to $8 million, which can be seen in the below chart.

SND - Revenue & EBIT



Source – S&P Capital IQ

BUILDING OUT THE CAPABILITY & DIVERSIFYING THE REVENUE BASE

With SND still very much focused on the construction and/or maintenance of liquid storage tanks, the SND team went about executing a strategy to diversify the revenue base, both by the industries in which they operate and by the services SND was able to provide. The initial step on this journey was the acquisition of Civilbuild, a small multidisciplinary concrete construction firm. Importantly, Civilbuild had an excellent reputation for its expertise in the design and construction of bridges, especially in regional areas. Such projects were a focus of a number of state governments, who were looking to replace many hundreds of old timber bridges.

Bridge – Woolgoolga to Ballina, Project value = $3.9m, 9 months build time.
Source – Saunders International

SND went on to build out what we can be considered its fourth division, focusing on automation and control solutions. This strategic move involved the acquisitions of two relatively small private businesses, Plantweave and Automation IT. These acquisitions enable SND to provide its current client base the 'smarts' required to run their assets in an efficient and high-quality manner. In the past, SND would often subcontract this type of work to external providers, like Sage Automation, when undertaking construction and maintenance projects. With the capability now in-house, SND can offer a comprehensive and integrated solution to its clients, serving as a one-stop provider for their automation and control requirements. An additional benefit is the ongoing revenues and long-term relationships with asset owners through the provision of automation services.

From an industry perspective, SND has been able to diversify into areas where there are significant tailwinds and a clear demand for SND services, with two examples being the Defence and Water industries. In our view, the demand from Defence for SND's capabilities has been driven by the complex and ageing infrastructure network that the Australian Defence Force needs to maintain and upgrade, as well as the demand from some of Australia's closest allies to set up infrastructure to support their own assets. This has seen SND awarded significant contracts such as work on RAAF Base Tindal, as well as a ~$165 million project in the Northern Territory which, once completed, will be handed over to the US Defence. The Water industry also has a number of similarities to the Defence sector in that it has a large amount of ageing infrastructure and also requires significant upgrades to meet the demand requirements from a growing population. As such, SND has been able to win a number of Water related projects with the likes of Sydney Water and Fulton Hogan, and we expect further notable wins over the next 24 months.

TAKING THE NEXT STEP

Over the last 2 years, SND has taken a significant step in building out both its physical presence, capabilities, and people. The business now operates in Australia and New Zealand, and a number of the Pacific Islands.

From a capability perspective SND is no longer just a construction business, but a one stop shop that can design, procure, manage, construct and commission large construction projects. This culminated in SND securing a $44 million contract with Quantem, which they had been working with previously on value engineering, optimising constructability and conducting a full lifecycle analysis of the project. Such capabilities will make SND more entrenched with their clients and become a trusted partner as opposed to a price driven contractor.

SND has continued to grow in a way that is clearly setting up the business for the future, with the ability to manage a much larger revenue base. Recent appointments include Trevor Walker, Waleed Mansour, and Eric Collins who bring extensive experience from their time at Ventia (ASX: VNT) and demonstrate SND's ability to attract top talent from larger firms.

In our view the future remains very bright for SND, and it exhibits many of the hallmarks that we look for in an investment. Namely, exposure to industry tailwinds, ability to reinvest and grow its competitive moat and build out a solid balance sheet driven by organic growth and free cashflow generation. We believe SND may look like a substantially different business over the next 3 years, but for all the right reasons.


NAOS
OUTLOOK

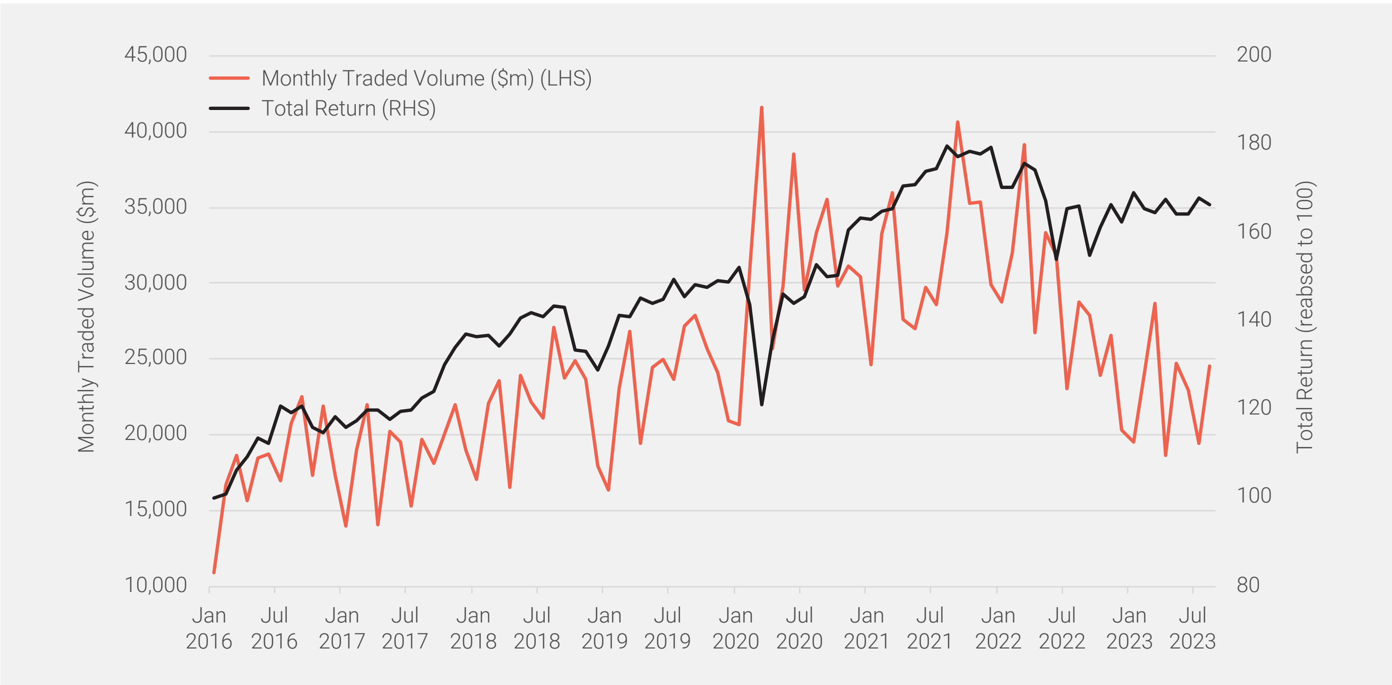
OUTLOOK

"Bull markets are born on pessimism, grown on scepticism, mature on optimism and die on euphoria" – Sir John Templeton

In our view this quote is timely for the current investing environment, given how poor the current market sentiment is, particularly in emerging companies or small caps. This is highlighted by the 2-year and 5-year price performance of the S&P/ASX Small Ordinaries Accumulation Index, and recent very low trading volumes in small caps, as shown in the below chart.

In our view, herein lies the opportunity, as sentiment remains low and prices move on small volumes, often the prices paid today are not a fair reflection of the underlying asset or business based on its long-term potential. We firmly believe that investor psychology is having too great an effect (rather than business fundamentals), which is leading to depressed share prices for many emerging businesses. We have learnt this is often the time to buy, be patient and back your investment process because once investor sentiment turns and earnings growth becomes more apparent, investors may well be paying 20-50% more to own these businesses.

S&P/ASX Small Ordinaries - Total Return vs Monthly Traded Volumes



Source – FactSet, Iress

Looking ahead, we believe there are several potential catalysts that will allow many of our investee companies to demonstrate tangible strategic progress in the near-term.

Urbanise.com (ASX: UBN) will provide a quarterly update and that will need to show some 'green shoots' after a challenging year. UBN stated that they are in negotiations on a new agreement with their largest client in the strata market which, depending on the details, could be a significant vote of confidence for the UBN offering. Q1FY24 will also provide a clear picture of the underlying organic growth in the business as the one-off (and large) loss of Ventia as a customer will have rolled off the comparable periods, and we believe a growth rate of >10% should be achievable.

UBN should also have finalised its operational review which should lead to cost base reductions without affecting productivity and customer retention. Improved cash conversion, particularly form its Middle East-based customers would also alleviate investor concerns.

COG Financial Services (ASX: COG) and BSA Limited (ASX: BSA) should also provide quarterly updates and an update on their respective profitability run rates relative to where they finished FY23. For BSA, sustaining the strong performance seen in 2H FY23 will be a focus, along with the ability to win further NBN work and diversify the business further into the smart metering and electronic vehicle charging industries. For COG the focus will be demonstrating underlying growth driven by salary packaging coupled with EPY moving back to profitability. If FB&A can remain stable despite reduced government tax incentives in FY24, this will be a further positive.

Gentrack Group (ASX: GTK) has a September year end so the FY23 result can be expected in November. GTK have already provided FY23 revenue and EBITDA guidance, but management do have a history of updating this guidance prior to more detailed updates at their HY and FY results. We expect another strong result as the industry tailwinds show no signs of abating (and potentially even accelerating) and the feedback on the GTK software itself remains positive. CEO Gary Miles wrote a short but thought-provoking article on how IT transformation is critical to driving the energy transition that consumers and policy makers are seeking. A full transcript of this article can be found here.

Finally, a number of AGMs will be held in October and November. This provides an opportunity for those businesses who did not provide FY24 guidance when releasing their FY23 results to provide more quantitative feedback based on the first 3-4 months of trading. In our case this could include the likes of MaxiPARTS (ASX: MXI), Saunders International (ASX: SND) and Big River Industries (ASX: BRI).

It is clearly an interesting time to be an investor in emerging companies but as Q4 FY23 provided us with several pieces to our investment puzzle, we are sure Q1 FY24 will provide the same along with a greater clarity of the true value and potential of many of these businesses.

Many thanks for your continued support, and we look forward to catching up with many of you at our national NAOS Investor Roadshow events this month.

Kindest regards,

Sebastian Evans

Managing Director and Chief Investment Officer
NAOS Asset Management Limited

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