NAOS

NAOS QUARTERLY INVESTMENT REPORT

Q2 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

Q2 FY24 SUMMARY

Dear Fellow Shareholder,

I am going to get straight to the point in this quarter's letter and try my best to address the question *"why are the smallest companies in the market underperforming so significantly and when will this change?"* It's the question that many investors are asking me but also the question myself and my fellow team members seem to ask ourselves on a daily basis.

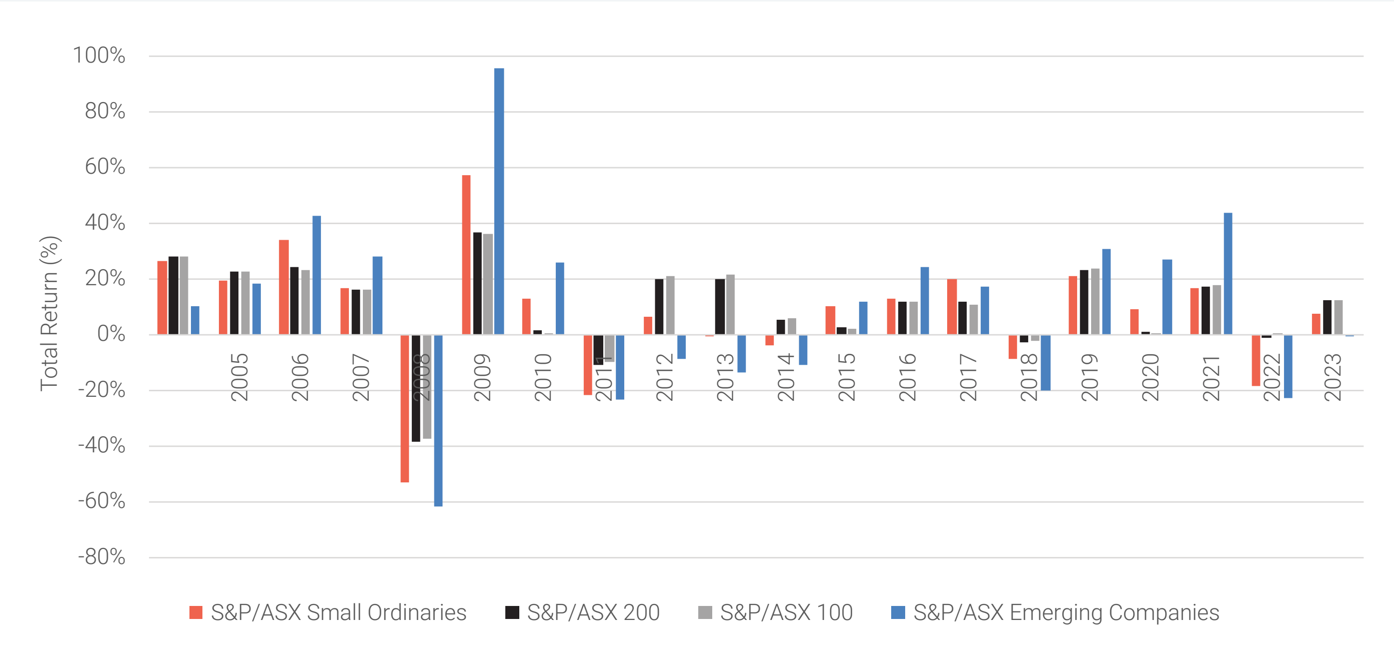
Firstly, let's discuss the underperformance of emerging companies over both the short term and the much longer term.

Emerging companies had a poor calendar year (CY), with the S&P/ASX Emerging Companies Accumulation Index returning -0.4%, underperforming its larger counterparts the S&P/ASX-100 and 200 Accumulation Indices which returned +12.6% and +12.4% respectively in CY23. While emerging companies have underperformed the S&P/ASX-100 Accumulation Index by a total of -36% over the last two years, there have also been periods where they have substantially outperformed their larger counterparts (2006, 2007, 2009, 2010, 2015-2017 and 2019-2022), as shown in the chart below.

When we look at long term averages for these indices, we come to expect a return closer to +8.0% p.a. Over the past 10 and 20 years, the return of the S&P/ASX Small Ordinaires Accumulation Index (XSOAI) has been +6.8% p.a. and +8.4% p.a. respectively.

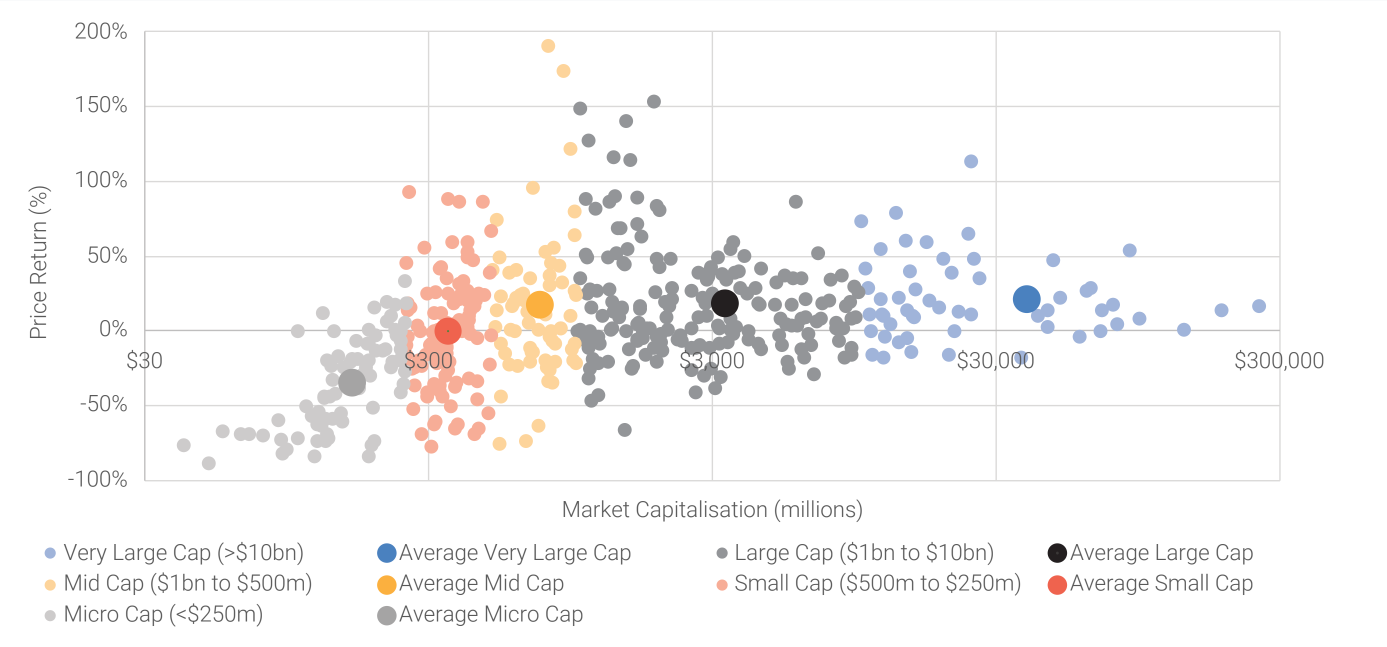
Delving further into the data, we can see that if we split out the smallest businesses within the XSOAI index, the underperformance has been much more significant. The diagram on the following page looks at the return profile of every business within the S&P/ASX All Ordinaires Index (XAOAI) for CY23 and allocates each business into a bucket based on the size of the business. As the majority of NAOS investments are within the <$250 million 'micro-cap' bucket, the yellow dots are of the most relevance. The average CY23 return of all the yellow dots is -34.2%, compared to +21.6% and +18.6% for the Very Large Cap (>$10bn market cap – blue dots) and Large Cap ($1bn to $10bn – grey dots) companies respectively.

Yearly Total Returns



Source: FactSet

Performance split by Market Capitalisation



Source: FactSet

Why are emerging companies underperforming in the current environment?
There is no one reason why the smallest businesses in the market are underperforming so significantly but, in our view, the most plausible reasons include:

- **Sharp Increase in Interest Rates** – Over the past 2-years interest rates have increased at their fastest rate on record. This has led to investors reallocating funds to asset classes that offer arguably more attractive risk-adjusted returns i.e. term deposits or even private credit products.
- **Economic Uncertainty** - Another impact of interest rate increases is the accompanying increase in economic uncertainty which leads to less certainty around the earning trajectory of a business.
- **Increase in Equity Risk Premium** – Due to several factors, including the above, the premium that investors expect from a return perspective over and above the risk-free rate has increased. Where investors may have previously been satisfied with a 6-7% p.a. return from equities, this has increased sharply in the current environment and therefore demand for equities, especially at the smaller end of the market, has significantly reduced.

What will be the catalyst for a reversal in fortunes for emerging companies?
In our view, in bear markets such as the one we are currently experiencing in the emerging equities space, investors can overthink the situation. We firmly believe the valuation re-rate that we will see in emerging companies over the next 3-5 years will be very meaningful.

We can't predict when this will happen but some of the elements that are required to occur include the following:

- **Interest Rate Ceiling** – Investors feed off stability and predictability and run from uncertainty. We don't believe interest rates need to fall significantly for emerging equities to re-rate. All that investors (and businesses) need is some surety that interest rates have reached a ceiling and will not increase further over the short to medium term.
- **Earnings Growth** – If businesses are able to provide a growing stream of predictable earnings growth, even at a moderate rate, we believe this will provide the impetus for increased investor interest.
- **M&A** – M&A can be associated with the very top of a bull market, but in our view M&A in a market such as the one we are in can provide a level of confidence for investors that the valuations or public businesses are not reflective of their long-term outlook or potential.
- **Risk Premiums** – If all of the above eventuate, then the premium that investors will demand from equity returns will decrease, which will therefore increase valuations prior to any earnings growth.

INVESTMENT PORTFOLIO PERFORMANCE SUMMARY

Investment Portfolio	Q2 FY24 Performance	1 Year Performance	3 Year Performance (p.a.)	5 Year Performance (p.a.)	Inception Performance (p.a.)
NCC Investment Portfolio Performance*	-3.38%	-8.56%	-2.53%	+2.56%	+7.76%
S&P/ASX Small Ordinaries Accumulation Index	+8.52%	+7.82%	+0.95%	+6.40%	+5.06%
NAC Investment Portfolio Performance*	-2.93%	+11.44%	+0.79%	+9.08%	+9.86%
S&P/ASX 300 Industrials Accumulation Index	+8.44%	+12.18%	+7.22%	+8.69%	+7.06%
NSC Investment Portfolio Performance*	-0.43%	+0.47%	+3.62%	+5.81%	+2.08%
S&P/ASX Small Ordinaries Accumulation Index	+8.52%	+7.82%	+0.95%	+6.40%	+4.21%

*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 December 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 31 December 2023)
Big River Industries	ASX: BRI	>20%	$175 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%	$274 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	5-20%	$107 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	5-20%	$149 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 29 sites nationwide.

		ASX Code	NAOS % Ownership (<5%, 5-20% or >20%)	Market Cap (as at 31 December 2023)
MOVE	**MOVE Logistics**	ASX/NZX: MOV	5-20%	$68 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	**Urbanise.com**	ASX: UBN	>20%	$24 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.

BTC health.	**BTC Health**	ASX: BTC	>20%	$17 million

BTC health is a distributor of medical devices and medical consumables to hospitals across Australia and New Zealand. It specialises in the areas of acute pain management, neuro spinal surgery as well as pharmaceutical medicines in niche markets. It also recently launched a new division which focuses on highly specialised cardiovascular equipment and consumables used by cardiac surgeons and crucial care experts.

Dropsuite	**Dropsuite**	ASX: DSE	<5%	$198 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	**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 CONNECTED DISTRIBUTION	**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

MAXIPARTS

MAXIPARTS LIMITED

ASX: MXI

Trading Update & Acquisitions of Independent Parts Group & Förch Queensland

The management team of MXI have shown no signs of slowing down and the acquisition of Independant Parts (IP) solidified MXI's ambition to be one of the largest players in the aftermarket truck parts space with a nationwide presence.

MXI paid ~$30 million for IP which generated ~$45 million of revenue and $3.4 million of EBITDA (pre-AASB 16) in FY23. IP is based in Western Australia with 4 standalone branches but many more 'embedded' sites. These embedded sites are essentially an IP store located within a client's main operation, for example a mining business which has the scale and requirement for an onsite parts provider to ensure any downtime to their mining operations are kept to a minimum.

At the time of the IP acquisition, MXI also acquired the Queensland distributor of Förch products which now gives MXI nationwide coverage of Förch products. Management also provided a trading update which saw core revenue growth (excluding ATSG-related revenues) of ~15% and a 33% increase in EBITDA to $5.7 million.

MXI's Melbourne distribution centre in Truganina.

From our perspective the pros and cons of the acquisition and trading update were as follows:

Advantages:

- **Increased WA Presence** – Prior to this acquisition, of all the states MXI operates in, it was weakest in Western Australia. But as Förch has shown (>90% of its revenues were WA sourced prior to acquisition by MXI) WA is a state that has substantial demand for MXI's products and services. The acquisition of IP now provides MXI with broader access to these markets across WA and the opportunity to expand its embedded business model.
- **Embedded Business Model** – We believe that ~50% of IP's revenue is derived from sites that are part of their embedded business model, a model that MXI did not employ prior to the acquisition of IP. We would argue this embedded model provides MXI with a significant competitive advantage, allowing it to deal directly with the customer at their site, truly understand their needs, and tailor services to meet those needs. If MXI delivers high quality service, is easy to do business with, and offers fair pricing, it becomes difficult to see MXI being displaced from these sites, especially due to the time critical nature of many of these part requirements. Furthermore, this successful embedded business model in WA could potentially be replicated on the East Coast, providing MXI with valuable optionality.
- **Core Business Growth & Margin Expansion** – As both margin and revenue growth formed the core part of our original investment thesis it was pleasing to see MXI continue to grow revenue as well as margins. The increasing demand for non-genuine truck parts, as customers recognise the benefits of non-OEM products, plays a significant part in MXI's top line growth. Additionally, compared to its closest listed peer, Supply Network Ltd (ASX: SNL), the EBITDA margin differential is >8%. Although a number of variables mean this is not an 'apples to apples' comparison, regardless of this we believe MXI has the opportunity for this margin profile differential to materially reduce over time.

Disadvantages:

- **Sophisticated Vendor, Price Paid & Deal Structure** – The IP business was previously majority-owned by a WA-based Private Equity firm. Sceptics will argue that such an investor/owner would have ensured that earnings potential of the business was maximised prior to sale. The fact that MXI paid 100% cash for the business also lends to the argument that MXI may have paid a full price with minimal protection if the forward earnings don't grow as expected. We should point out that a Q1 FY24 trading update was also provided for the IP business, and pleasingly showed IP making $1.5 million in EBITDA, compared to $3.5 million for the entirety of FY23.
- **Equity Raising** – An attribute that first attracted us to MXI was the significant free cash flow generation, driven in part by strong gross cash flow conversion, minimal capex and approximately 3 years of income tax losses. As such, we found it a little disappointing that MXI's board opted to fund the acquisitions with a $17.2 million placement (with no access to retail investors) at a 10% discount to the last share price. For context, we anticipate net debt to be $11 million at the end of FY24, relative to an EBIT of approximately $17 million. In our view, MXI could have debt funded the entire acquisition, resulting in net debt at the end of FY24 being roughly 1.5 times EBIT. Looking forward, assuming management continue to execute as they have done so previously, we would expect the board to adopt a capital management strategy that is more aligned with MXI's cash flow generative nature and balance sheet strength.

MXI remains one of our highest conviction investments held across the NAOS portfolios with Peter Loimaranta and his team doing an exceptional job in a short period of time. This acquisition was not as clear cut as the two previous deals, but in our view MXI has all the necessary elements to drive profit margin expansion, which should in turn lead to a valuation re-rating, especially when combined with a well-executed capital management strategy.

Robert Miller and Jared Tilley outside Independant Parts in Welshpool, WA

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SAUNDERS INTERNATIONAL

SAUNDERS INTERNATIONAL

ASX: SND

Acquisition of Piping Solutions

SND also completed a deal of similar size to MXI, albeit funded via different means. SND announced that it had acquired Piping Solutions (PS) for an initial payment of $13 million on a debt-free, cash-free basis plus an earn-out payment up to $7 million. Piping Solutions was established in 2004 and today employs ~100 people, and in FY23 generated $3.6 million of EBIT on revenue of circa $41 million. Importantly, the transaction was 50% funded from SND's available cash with the vendors taking the balance in SND scrip. This is a very positive outcome for SND in our view as it demonstrates the belief that the vendors have in SND's strategy, particularly considering the illiquid nature of SND shares.

We believe PS will be a highly complementary offering for several key reasons including:

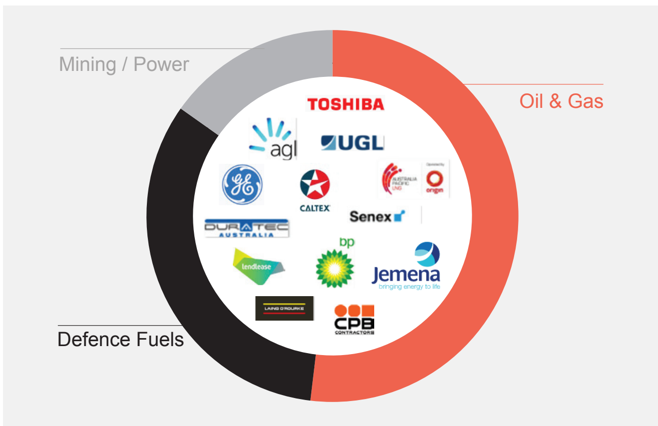
- **Complementary Offering and Skillset** – SND initially grew their business out of building large liquid storage tanks, and as such it makes sense for them to offer their clients a more complete solution that includes both the tank and all associated piping elements. PS and SND have worked on a number of contracts together, highlighting their complementary capabilities. PS fabricates and installs steel piping solutions as well as offering complete maintenance programs for existing steel piping infrastructure. One major project that PS has recently completed was the hydrant line at the new Western Sydney Airport (see picture on right). Essentially the acquisition of PS will allow SND to capture more of the dollars that it tenders on as opposed to subcontracting these specialised skills out.
- **Exposure to Defence** – Over the past few years PS has gained significant exposure to contracts awarded by the Department of Defence which represents ~40% of PS' revenue. It is in the process of completing a large contract at RAAF Tindal as well as providing fuel installation and maintenance services for 6 other defence sites. SND has been on a multi-year journey to gain the credentials and expertise required to tender directly on large defence opportunities, and the acquisition of PS further enhances this strategy as well as building out a well credentialed CV of successfully completed jobs.
- **New Energy Markets** – SND has been building out its capability to ensure a successful entry into new energy markets and PS accelerates this. These markets include areas such as Hydrogen, Green Hydrogen and Biofuels. Interestingly many of the green energy technologies that are being developed will require not only a storage mechanism but also distribution and potentially refining infrastructure. PS, with its recent collaboration with the Scaling Green Hydrogen CRC and a diverse client base, strengthens SND's position in these evolving markets. Some of PS' clients are outlined in the pie chart below.

It has been a productive FY24 for SND so far, with management rebuilding their order book post the completion and closure of the $160 million Project Caymus as well as the completion of the Automation IT and Piping Solutions acquisitions. From what was originally solely a tank construction and maintenance business, SND is now well on its way to becoming a multidisciplinary contracting business that can deal directly with Tier-1 clients and offer unique solutions few other contractors can.

Key Project – Western Sydney Airport New Hydrant Line

Source: Saunders International Presentation 8 November 2023

Piping Solutions - Key Clients



Source: Saunders Acquisition Presentation

COG FINANCIAL SERVICES

ASX: COG

Q1 FY24 Trading Update & Acquisition of 19.99% Stake in Centrepoint Alliance (ASX: CAF)

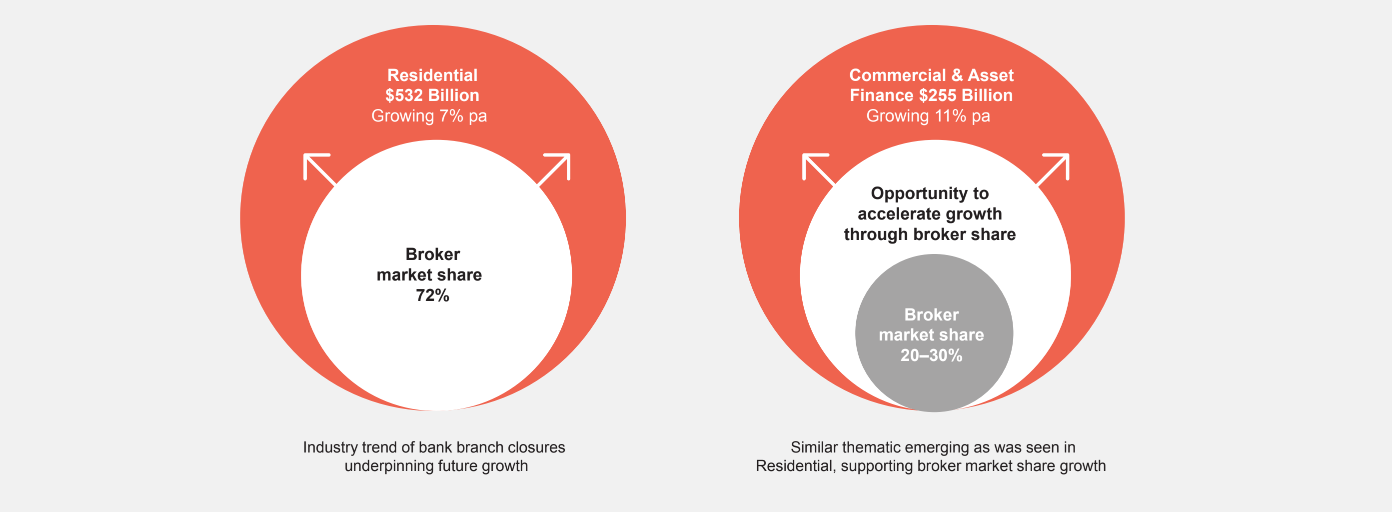
COG provided the market with its Q1 FY24 results, which were the first results with the newly formed Novated Leasing division split out from the Finance Broking & Aggregation (FB&A) as well as the Funds Management Division (FM).

What stood out to us in this release is that the diverse nature of COG means that it has multiple levers to drive organic growth, and in our view is more immune to an economic slowdown than some would think. As an example, while the FB&A division reported a flat quarter-on-quarter result which was expected given the very strong corresponding period, this was more than offset by the stellar growth in the novated leasing business. Over just 12 months, the Novated Leasing division's NPATA grew from $900,000 to $2.4 million. As we have mentioned in our previous commentary, we believe that the COG Novated Leasing business, in collaboration with 30% owner EML Group has the potential to be a top-3 player in the Australian market. The market is currently dominated by Smartgroup Corporation (ASX: SIQ) and McMillan Shakespeare (ASX: MMS), and we believe based on feedback from industry participants many customers would be receptive to using an alternative provider who can offer an improved service offering.

Towards the end of the quarter COG acquired a 19.99% interest in ASX-listed Centrepoint Alliance (ASX: CAF). CAF offers many of the same services as COG does for its finance brokers, but for financial planners. It has 500 licensed financial planners as well as 190 self-licensed practitioners who use the CAF services. Over the past 8 or so years COG has developed a platform that can not only be applied to finance brokers but also insurance brokers and mortgage brokers. The financial planning industry has gone through a significant amount of upheaval recently, and has returned to its more fragmented, cottage industry roots. This situation provides a significant growth opportunity for COG. Notably, all 3 existing COG divisions share a commonality in their customer base, which primarily consists of thousands of small to medium enterprises. These SMEs will generally require finance to acquire equipment, a mortgage for a commercial property, insurance to go with the property or equipment, and their executives potentially require financial advice, making the financial planning sector a logical extension for COG's diversified offerings.

It will be imperative that COG's management can articulate this strategy effectively and highlight the synergies both from a revenue perspective but more importantly from a skillset perspective. Despite reasonable profit results over the years COG is yet to experience a valuation re-rating. If COG's entry into the financial planning industry can further broaden its organic growth opportunities in a capital light and efficient manner, then we believe it's only a matter of time until the market will realise the significant potential for scale that COG possesses.

As a sidenote, listed competitor Australian Finance Group (ASX: AFG) held their strategy day in early November. Within the presentation materials released to the ASX, a significant portion of the content focused on Fintelligence and AFG's strategy for growth within the equipment finance space. As a point of comparison, AFG settled approximately $2.5 billion of equipment loans in FY23 whereas COG should settle >$10 billion in FY24.



Source: Australian Finance Group – Strategic Investor Briefing

URBANISE.COM

ASX: UBN

Quarterly Activities Report, Operational Review & Board Appointments

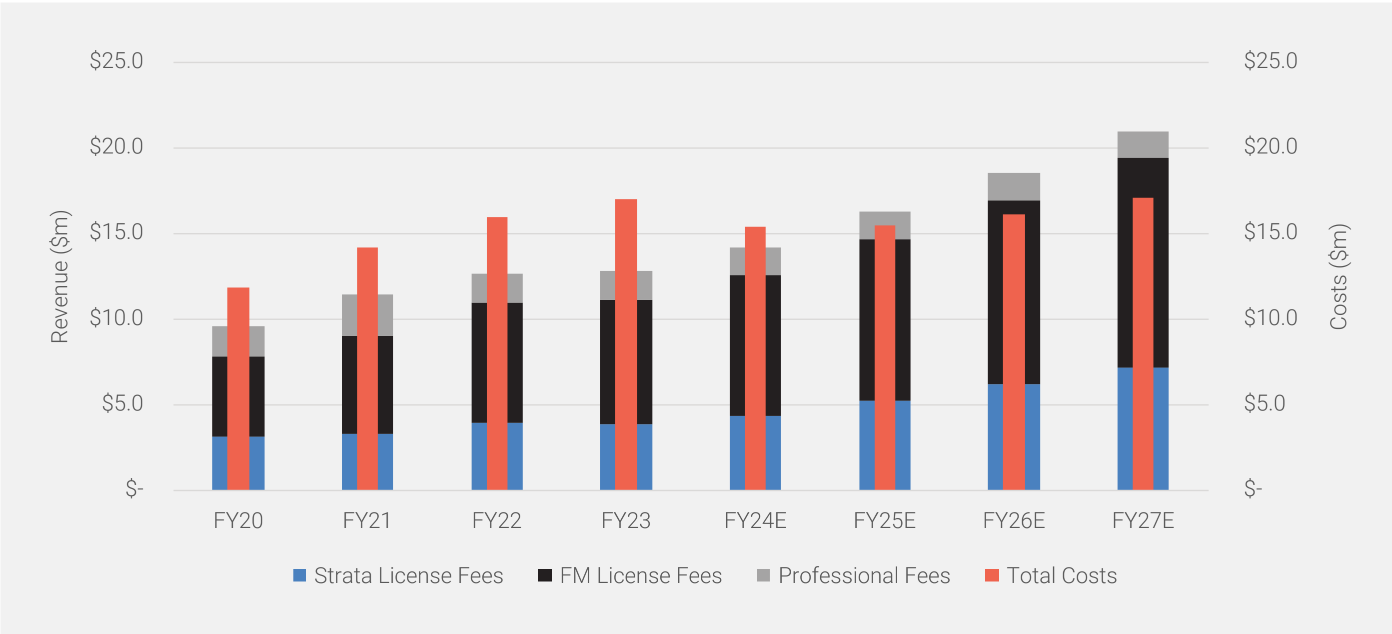
In theory, FY24 should be the year where UBN can prove to the market that much of the hard work that occurred during FY23 and into FY24 is now translating into green shoots and therefore revenue growth, ultimately leading to business profitability.

Starting with the Q1 update, total revenue on a headline basis decreased by -3%, primarily driven by a decline in professional service fees (one-off in nature) as license revenue, which is recurring, increased by +3.1%. After the end of the quarter UBN announced they had won a further $0.43 million of ARR wins in October alone. UBN also stated that the contract renewal process with their largest strata customer is continuing. During these ongoing negotiations, UBN's ARR has remained flat despite revenue from this customer decreasing by $0.15 million over the quarter, or $0.60 million on an annualised basis. On a cash basis, the business incurred a net loss of $0.72 million over the first 3 months of FY24.

Prior to the release of the quarterly update UBN announced the start of efficiency programs that is targeting a $2.4 million improvement in cash flows over the next 12 months, consisting of $1.1m in headcount savings, and $1.3m in non-wage overheads and working capital improvements. We believe that the impact of these cost savings, coupled with a successful renegotiation with their largest strata customer, and circa $0.2 million per quarter of further ARR wins should see UBN return to a positive cash flow position on a quarter-by-quarter basis over the next 6-12 months.

Finally, UBN completed its board renewal process which has seen the appointment of Darc Rasmussen as Independent Chair as well as the appointment of James Hourn (an executive at Readytech) as an Independent Director. In our view, these two appointments are exactly what UBN needs, as both have excellent, relevant experience in software businesses both from a development and sales perspective. In the case of Darc, UBN now has a Chair who has highly credible ASX experience with the likes of Gentrack Group (ASX: GTK) and Objective Corporation (ASX: OCL).

Urbanise.com - Pathway to Profitability



Source: NAOS internal estimates

GENTRACK

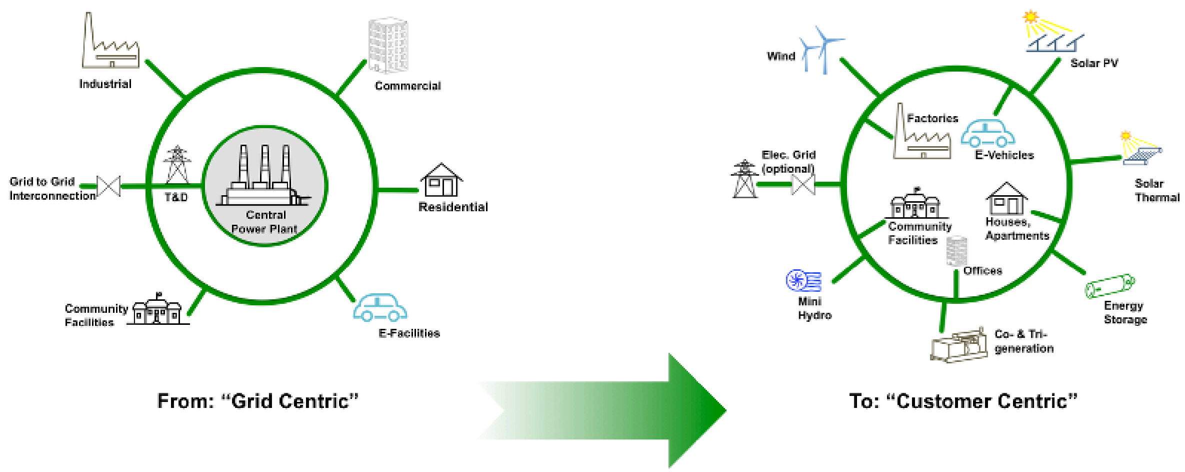
ASX: GTK

FY23 Results

With a September year end, GTK released its FY23 results to the market at the end of November, and in what has become a pattern under the current management team, the results did not disappoint. Furthermore, the FY23 results also featured a revenue guidance upgrade for FY24. On an underlying basis excluding revenue from customers that either defaulted (SoLRs that occurred within the UK market) or left GTK, revenue growth was >40%.

It was not long ago (~2 years) that GTK shares were trading at close to $1 and many in the investment community felt that GTK would require a significant amount of investment just to remain relevant, let alone win new work competing against businesses such as Kraken (owned by Octopus Energy Group). Fast forward to today and the rhetoric regarding GTK and its potential has changed significantly, due to key factors including:

- **G2.0 Is the 'Real Deal'** – The most common push back we heard around the time of our original investment in GTK was that their product(s) were old, cumbersome and didn't have the support behind them. Today, CEO Gary Miles and his team have built their new offering (G2.0) in such a way that is not only capital efficient but also fit for purpose from a market perspective. This is starting to translate into success, evidenced by the recently announced deal with Genesis Energy (ASX: GNE) in New Zealand. Management have also done a fantastic job of reinforcing to customers that for any perceived (and arguably legacy) weaknesses, GTK is still yet to have even a single failed billing implementation. Very few, if any competitors would be able make such a statement. In our opinion a track record of implementation success is a very important factor for any enterprise software company, whereby failures can be extremely costly from both a time and financial standpoint. Therefore, GTK should pose a lower-risk option from a customer standpoint, a great starting point for its next generation G2.0 software offering.
- **Partnership With Salesforce** – The old saying "if you can't beat them, join them" is very much applicable to GTK's partnership with Salesforce. GTK could not and would not be able to build a CRM equal to the one offered by Salesforce. Furthermore, Salesforce does not have the experience and strength of offering when it comes to the specialised nuances of utility billing platforms. Therefore, a partnership between the two business makes a significant amount of sense as it gives the customer the ideal outcome, being best of breed billing and customer service software in one. For GTK it also strengthens their overall proposition and access to a number of utility customers who use Salesforce for their CRM but are yet to upgrade their billing system from legacy providers.
- **The Market Opportunity is Significant** – As more consumers seek both a renewable energy source, as well as produce their own renewable energy, the utility companies that they deal with will need to provide a customer experience that is fit for their customer needs. Frankly, many of the main utility billing systems which were developed 10-20 years ago are not fit for purpose and in some cases will no longer be supported by their vendors in the next few years. This is providing utilities with a major catalyst to review their entire billing and CRM platforms and ensure it will be fit for purpose as the world transitions to renewable energy. This is depicted in the below image with a focus on customer centric operating model.



Source: United Energy Ventures

The future of GTK remains as bright as ever and as management have delivered or exceeded expectations a number of times, the valuation of GTK has been re-rated significantly. Due to this GTK is no longer a NAOS core investment, but it remains a company we will be watching closely as the growth prospects for this business remain far greater than its existing operational footprint.

MITCHCAP

MITCHCAP CONNECTED DISTRIBUTION

UNLISTED

Major Competitor Exiting Australian Market

In the relatively unknown world of Commercial Distribution Finance, or floor plan financing (ex-auto) a significant event occurred in late October with Wells Fargo (US: WFC) announcing that they would be closing down their offering to the Australian market over the next few months.

Wells Fargo entered the market by acquiring the business units off GE Finance back in 2016 (many in MitchCap were part of that original GE team). We believe that prior to this announcement, Wells Fargo was the largest player in the non-auto floor plan finance space, so their exit will create a significant amount of customer churn. This is both an opportunity and a risk for MitchCap as they are keen to continue to grow their loan book and customer base, but we expect it could be to the detriment of overall business profitability given the likely pricing that Wells Fargo would have offered. From a customer perspective the three main options will now be Bank of Queensland, Rabobank (DLL) and MitchCap. MitchCap has never been the cheapest alternative however it can provide its customers with a more holistic offering and flexibility that is well suited to many SMEs.

We will be eagerly watching the progress of MitchCap to see what unfolds post the exit of Wells Fargo and how MitchCap management have been able to take advantage of the opportunity yet maintain a key focus on overall loan book yield.

NAOS

INVESTMENT IN FOCUS

BSA LIMITED

ASX: BSA

OVERVIEW

BSA Limited has been an ASX listed business since 1999 and it's fair to say over the majority of those years it has been a business dragged down by a number of ill-advised acquisitions and poor strategic execution by various management teams. Essentially, BSA is a contracting business which specialises in providing assurance and maintenance services for telecommunication and associated infrastructure through its network of employees and subcontractors.

Its key competitive advantage is its decentralised field team with ability to handle thousands of small jobs per week in a residential environment across numerous states in Australia. Examples of the work that BSA has completed over the years includes being a major partner with Foxtel throughout its existence for the installation of set top boxes, and more recently has been a key partner with NBN for the activation and connection of residential services to the NBN network.

NAOS has been a shareholder in BSA for approximately 10 years. We were initially drawn to the new management team which was led by Nick Yates (current Chairman), who had previously led the Transfield Infrastructure division. Under the stewardship of Nick and his team the business entered into a number of large and ongoing contracts with NBN which to this day remains the largest customer of BSA.

Approximately 3 years ago BSA faced its most extreme challenge. The business was dealing with a lack of contract volumes across both its telco and asset management divisions due to COVID related restrictions on contracts and a lack of profitability due to poor pricing and project management on jobs. The business was also in the midst of a class action relating to categorisation of contractors vs. full time employees. What used to be a solid net cash balance sheet was fast falling away to a significant net liability position when the Class Action was settled for $20m to be paid over 3 years. With a view to assist in stabilsiing the business and restoring value, we took action and sought for the appointment of NAOS representative, Brendan York to the BSA Board.

Over the past 2 years the business has slowly but surely transformed itself into a simpler business following some sensible divestments, with a new management team and balance sheet that has the potential to deliver solid returns in the not-too-distant future. During this time, many of the executive team have been replaced and optimised, the underperforming (and loss making) APS Division was sold to CBRE, and the last remaining core division of the group (CUI) has returned to near industry-leading margins and a stabilised revenue base. This has resulted in BSA being able to broadly self-fund the remaining liabilities associated with the settlement of the class action and other legacy items.

To highlight just how far BSA has come, as per their Q1 FY24 update the business produced ~$57 million of revenue that led to $4.4 million of EBITDA (7.7% margin after all corporate costs). From a balance sheet perspective, the last reported net debt was $2.8 million excluding the final class action payment of $9 million due half-way through CY24. Importantly, the business has minimal depreciation and amortisation expenses with limited fixed asset investment required and will also not be in a tax payable position for quite some time given the sizable amount of carry forward tax losses. The current market capitalisation of BSA is just $43 million.

So why are we cautiously optimistic about BSA's future?

- **Business has returned to stable profitability** – As mentioned above BSA has now returned to stable profitability that importantly is translating to positive cash flow and a de-gearing of the balance sheet. This is not just important from a financial or valuation perspective but is vitally important when dealing with customers, driving a more positive employee culture and business development initiatives.
- **NBN will continue to upgrade and maintain the network** – There is no doubt that NBN is crucial to the future of BSA. It is by far and away its largest customer, but by the same token BSA is the largest delivery partner of NBN for activation and assurance services. In our view NBN will need to continue to invest in its network to ensure that its offering is at the very least competitive to other technologies, but also to keep up with (or ahead of) consumer demand preferences, which will ultimately lead to higher data usage. The key risk is that BSA does not maintain a service level that meets and exceeds NBN's standards and therefore work is directed to other delivery partners and contractors. As NBN seeks to grow profitability, we expect over time it will reduce the number of contractors it deals with to maximise efficiencies. This should lead to the remaining service providers gaining a larger share of the pie.
- **FY25 will see no major financial liabilities** – Based on the current run-rate of profitability, and assuming this translates into a similar cash result, we expect that all remaining debt-like financial liabilities will be satisfied by the end of FY24. This will give management and

the board more flexibility regarding new business development opportunities, M&A, or even capital management.

- **Adjacent opportunities such as EV charging installations etc.** – In our view the decentralised national field force that BSA manages can be applied to several adjacent offerings particularly in other areas of electrical, new energy and telecommunications infrastructure. The manufacturers of products such as EV chargers or smart meters will ultimately require installation by another party specialising in delivery of services. As BSA has a national presence and a long history of safely delivering national rollouts in residential settings it should be an attractive partner for many businesses participating in the ongoing electrification of the country. BSA has already secured relationships with Vector and Intellihub in relation to the roll out of smart metering in the energy markets, as well as installation assignments with Evie Networks and Tesla for EV charging stations. The unknown for BSA will be how profitable such opportunities are and whether customers prefer to work with a national provider or smaller SME operators particularly in these emerging industries like EV charging where there doesn't appear to be a co-ordinated national network planned. Regardless, the transition to EVs will be a nationwide opportunity that will have an effect on most if not all households, so the physical opportunity is significant. Whether this translates into a profitable opportunity for BSA is yet to be seen.

BSA's Latest GoEvie Charging Station in Dunkeld, Regional Victoria.

Source: BSA

BSA is now at an interesting juncture and one which we believe is filled with significant opportunity (but some not insignificant risks). The new management team have done an excellent job getting the business to where it is today, and in our view the next 18 months will show just how far this team has come and what value they have created for all shareholders.


NAOS
OUTLOOK

OUTLOOK

This quarter's outlook commentary will be kept short.

As you can conclude from the above, we believe many, if not all, of our core investments are making significant progress regarding building out their respective businesses which in turn should lead to a more defendable moat and long-term earnings growth.

We expect a significant majority of our core investments to grow their earnings per share (EPS) in FY24, which should lead to healthy dividend profiles, regardless of the macro backdrop.

We can't control share price movements which can be a source of significant frustration in the short-term but provide a significant opportunity over the longer term.

Directors have continued to increase their shareholdings in the NAOS LICs and we remain of a firm conviction that the long-term valuation uplift potential will be realised – it is just a matter of time.

The NAOS team greatly appreciates your continued support.

Kind regards,

Sebastian Evans

Managing Director and Chief Investment Officer
NAOS Asset Management Limited

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