NAOS

NAOS QUARTERLY INVESTMENT REPORT

Q4 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

Q4 FY24 SUMMARY

Dear Fellow Shareholders,

I recently wrote a letter to shareholders of the NAOS listed investment companies (NAOS LICs) which was issued on 6 June 2024 and addressed in detail the poor performance that the NAOS LICs have experienced in 2H FY24. I will avoid repetition here, however, to be clear, we are very aware of the recent poor performance but remain very optimistic on the long-term outlook for the core investments across the NAOS LICs. We will also continue to add to our significant investments across all the NAOS LICs by reinvesting a portion of the management fee proceeds through acquiring shares on market (read here NSC, NCC, NAC).

Unsurprisingly, given how disappointing the FY24 investment portfolio performance has been, there has been many a time where we have asked ourselves as an investment team if a concentrated, active investment strategy with an exposure to emerging companies will produce the risk-adjusted returns investors expect? Earnings in a number of cases have disappointed, and the demand from investors for exposure to emerging companies (and therefore the valuation multiples applied) has decreased dramatically, with the combined result being significant falls in share prices. However, we believe over the long-term our investments will achieve substantial earnings growth that will also convert into cash earnings. This should drive a significant re-rate of the valuation multiples applied to these businesses, particularly given the low multiples applied to them today.

I would argue that the valuation multiples currently applied to many emerging businesses are so low not only due to the lack of recent earnings growth, but also because of the rise of passive investing, as discussed below. This has seen many investors move away from investing in emerging companies, especially those with poor liquidity profiles. Additional factors, such as stubborn cost inflation, the wider slowdown in economic activity, and alternative investment options have also recently impacted the earnings of emerging businesses and investor demand for exposure to these businesses, as further elaborated on below.

CONTINUED RISE OF PASSIVE INVESTING

Earlier in the year, highly regarded US-based investor, David Einhorn, gave an excellent analysis on what is moving markets today, particularly on the changing structure of the market.

He argues that a significant portion of investment capital in the market either cannot assess valuations due to a lack of training, does not care about valuations (i.e. passive index funds or ETFs), or intentionally ignores valuations in favour of price-focused strategies (i.e. technical or quantitative strategies).

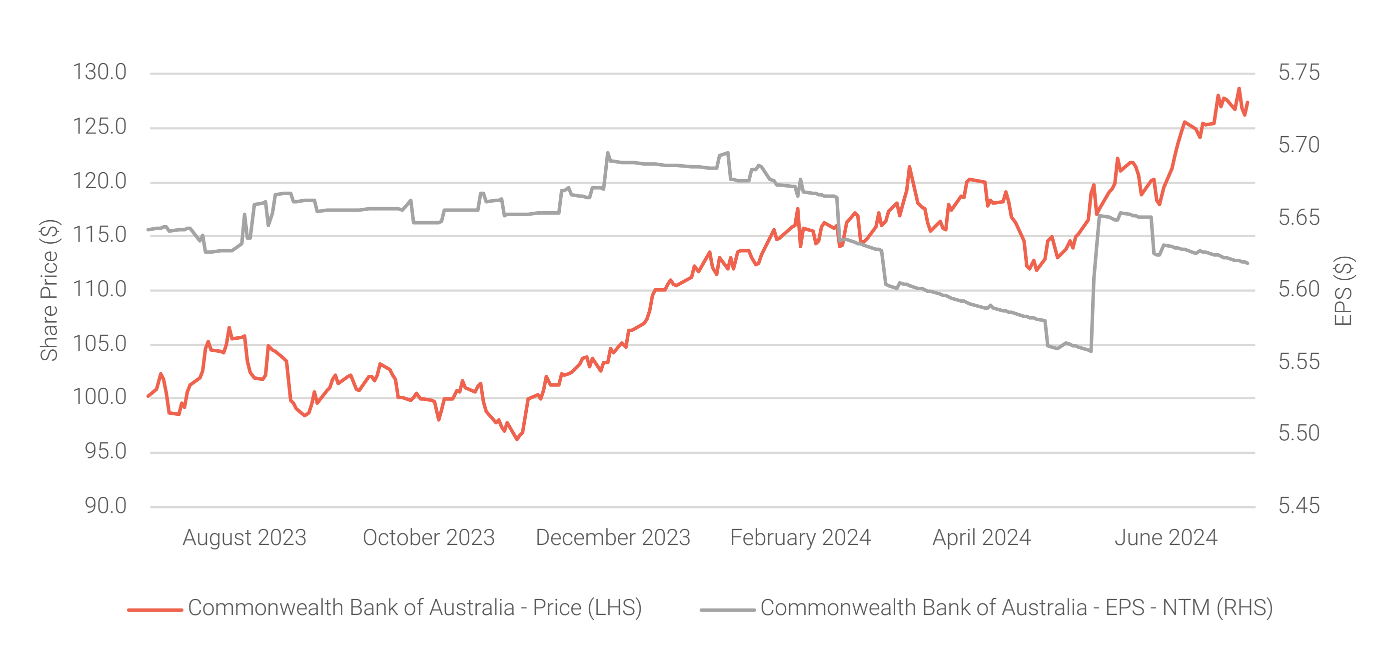
Einhorn illustrates this with an example of two companies both having a fair value of $1 billion. If one is undervalued by the market and has a market capitalisation of $500 million, and the other overvalued with a market capitalisation of $2 billion, a market capitalisation-weighted index fund investing $5 will allocate $4 to the overvalued company and only $1 to the undervalued one. This leads to the overvalued stock receiving disproportionately more investment, causing it to outperform, while the undervalued stock underperforms.

This issue is compounded when new investments into index funds come from redemptions from active managers who had previously allocated more to undervalued stocks. When money is withdrawn from these active managers and reinvested in index funds, the undervalued stock faces net selling, and the overvalued stock sees net buying, driving their valuations further apart.

The rise of passive investing over recent years has seen several trillion dollars redeployed in this fashion, which in Einhorn's words "has fundamentally broken the market".

Looking at the ASX, Commonwealth Bank of Australia (ASX: CBA) would be the prime example of this in the domestic market. As at 30 June, CBA shares were trading at $127.38, just below their record high. The share price has increased by +26.2% over the last 12 months and inclusive of dividends, has delivered a total shareholder return of +31.7%, markedly higher than the S&P/ASX-200 Accumulation Index FY24 return of +11.4%. Where the increase in CBA shares ties in with Einhorn's comments is in relation to its EPS growth. FY24 EPS is expected to decrease by -1%, then looking ahead to FY25, consensus estimates are forecasting earnings growth to be negative again, circa -3%. As such, currently CBA trades on a price to earnings multiple of 21.9x and given the decrease in EPS for FY25, this will increase to 22.7x.

Commonwealth Bank - Share Price Vs EPS



Source - FactSet

Commonwealth Bank – Key Metrics

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024E
EPS	5.54	5.42	5.77	5.34	4.86	5.43	5.75	6.25	6.04	5.81
EPS Growth	4%	-2%	6%	-7%	-9%	12%	6%	9%	-3%	-4%
Share Price ($)	84.67	74.37	82.81	72.87	82.78	69.42	99.87	90.38	100.27	127.38
P/E Multiple	15.3	13.7	14.3	13.6	17.0	12.8	17.4	14.4	16.6	21.9

Source - FactSet

So why is the price of CBA shares at a record high? When considering the current macro environment, one that is more conducive to low credit growth and increasing bad debts, this appears illogical. However, let's not forget CBA is the second largest business on the ASX by market capitalisation and a highly liquid one. It has provided investors with a relatively stable stream of dividends and in theory should continue to do so. If you have exposure to an Exchange Traded Fund (ETF) that seeks to provide exposure to the ASX-100, Australian financials or even large, listed businesses in Asia, chances are that CBA will form part of that exposure. As these ETFs continue to increase in size and popularity, many of them will continue to acquire CBA shares regardless of price and/or value.

SLOWDOWN IN ECONOMIC ACTIVITY

As emerging companies, many of the largest investments across the NAOS LICs are more sensitive to economic activity levels than larger companies. Since February, the consensus view is that economic activity has slowed significantly or at least deviated from expectations. Several examples of this include:

- **Slowdown in new car turnover and increased inventory** – We have heard from numerous sources that auto dealers are now holding excess inventory, leading to discounting on new cars as well as higher costs associated with floor plan finance etc.
- **Reduced logistics movements** – In both Australia and New Zealand there has been a notable reduction in truck movements especially those associated with the transportation of construction materials and retail inventory. There has also been a reduction in movements of staple items such as groceries. Some of the knock-on effects include reduced demand for new and used trucks, and even a short-term decrease in demand for truck parts.
- **Project delays** – Both commercial and residential construction projects are experiencing persistent delays. It has never taken longer to build a new home in Australia, and commercial projects are facing significant delays due to regulatory requirements, cost pressures and difficulties in sourcing skilled labour. These delays have a knock-on effect for the businesses contracted to build these projects and the suppliers of the raw materials.

- **A weary consumer** – With interest rates remaining elevated for some time yet, pressure is mounting on consumers and SMEs, making them more price conscious in their buying activities. Volumes in some sectors remain resilient but gross margins are under pressure, especially for businesses striving to maintain volumes in sectors such as building materials, the automative sector, and more discretionary retail.

STUBBORN COST INFLATION

In previous economic cycles pressure at a top line level or even gross margin level have been able to be partially offset by careful reductions of costs associated with the fixed cost base. However, in the current cycle the effects of inflation have made this much more difficult or near impossible. This has led to numerous downgrades from listed businesses over the past few months, as shown in the tables below.

Australia - Notable Downgrades in May

Code	Company	Sector	May % Share Price Movement	Downgrade commentary
APE	Eagers Automotive	Auto Dealerships	-20%	Cost of living pressures, consumer spending, inflation driving cost of goods sold increases
SUL	Super Retail Group Limited	General Retail	-11%	Group like for like sales -1% in 2H (Rebel Sport -2% and BCF -5% in the same period)
JBH	JB Hi-Fi Limited	Discretionary Retail	-5%	Q3FY24 Sales weaker than expectations and a clear deterioration in sales trends for March/April
BBN	Baby Bunting Group Limited	Discretionary Retail	-25%	Trend of improving comparative store sales that was observed in period to Feb has softened over the last 2 trading months
BAP	Bapcor Limited	Auto Parts/Servicing	-26%	Trading conditions remain challenging due to weak consumer confidence and lower discretionary spending
SUN	Suncorp Group Limited	Banking	-4%	Total 90+ days past due loans increased $85 million, up 11bps on prior quarter
LIC	Lifestyle Communities Limited	Housing	+3%	15% Reduction in new home sales as customer are taking longer to sell their homes
WOW	Woolworths Group Limited	Consumer Staples	-1%	Q3 FY24 sales results release described a noticeable shift in customer sentiment and shopping behaviours since Christmas.
PWR	Peter Warren Automotive Holdings	Auto Dealerships	-20%	Lower new vehicle demand due to cost of living pressure and contraction of margins across the industry
AHL	Adrad Holdings Limited	Auto Parts	-23%	Deferral & cancellation of projects with demand in distribution market softening particularly for industrial radiators.

New Zealand - Notable Downgrades in May

Code	Company	Sector	May % Share Price Movement	Downgrade commentary
FBU	Fletcher Building Limited	Building Materials	-18%	13% Profit downgrade (3rd in recent times) attributed to weaking demand and increased competition.
WHS	The Warehouse Group	Consumer Staples	-26%	Trading update for 13 weeks to 28 April 24 noted sales declined by 9.2% pcp with conditions remaining highly uncertain
MHJ	Michael Hill International	Discretionary Retail	-36%	NZ segment remains the most challenged with significant impacts to consumer behaviour and discretionary spend.
THL	Tourism Holdings Rentals Limited	Discretionary Leisure	-35%	Downgraded NPAT forecast by -30% due to weakening economy in particular vehicle sales.

Australia - Notable Downgrades in June

Code	Company	Sector	June % Share Price Movement	Downgrade Commentary
KMD	KMD Brands Limited	Discretionary Retail	-13%	All three operating divisions, Rip Curl, Kathmandu & Oboz, declined as a group 14% in 1H24 and 8% in 2H24. Broad weakness across discretionary retail.
CTT	Cettire Limited	Luxury Retail	-50%	Luxury businesses experiencing softening demand trends and increased promotional activity, leading to a tough margin environment.
MTO	Motorcycle Holdings Limited	Discretionary Retail	-28%	EBITDA down 50% FY24 vs FY23, driven by challenging market conditions due to escalated costs and sustained gross profit margin pressure.
MOZ	Mosaic Brands Limited	Discretionary Retail	-32%	2H24 earnings under pressure due to challenging conditions in the "discretionary consumer sector more broadly" and softness in consumer spending
IEL	IDP Education	Education	-5%	Structural industry volume problems, "The visa data shows that for the first quarter of CY24 aggregate industry volumes to Australia, UK and Canada are down between 20 and 30% versus the same period last year"
GWA	GWA Group Limited	Household Goods Distribution	4%	Total Group Revenue to remain flat YOY, due to a continued deterioration in the New Zealand business due to weakness the in housing and construction markets.

Several large cost items such as leases and wage costs have contracted increases that are tied to CPI. With inflation levels significantly higher in FY23, this led to a sharp increase for costs such as rent and wages in FY24. But unlike in FY22 and FY23, demand has reduced and the ability for a company to pass on price increases to offset these inflationary pressures has reduced significantly. This has resulted in lower margins and in some cases, significantly lower margins, as businesses have been unable to cut costs as aggressively or as quickly as needed.

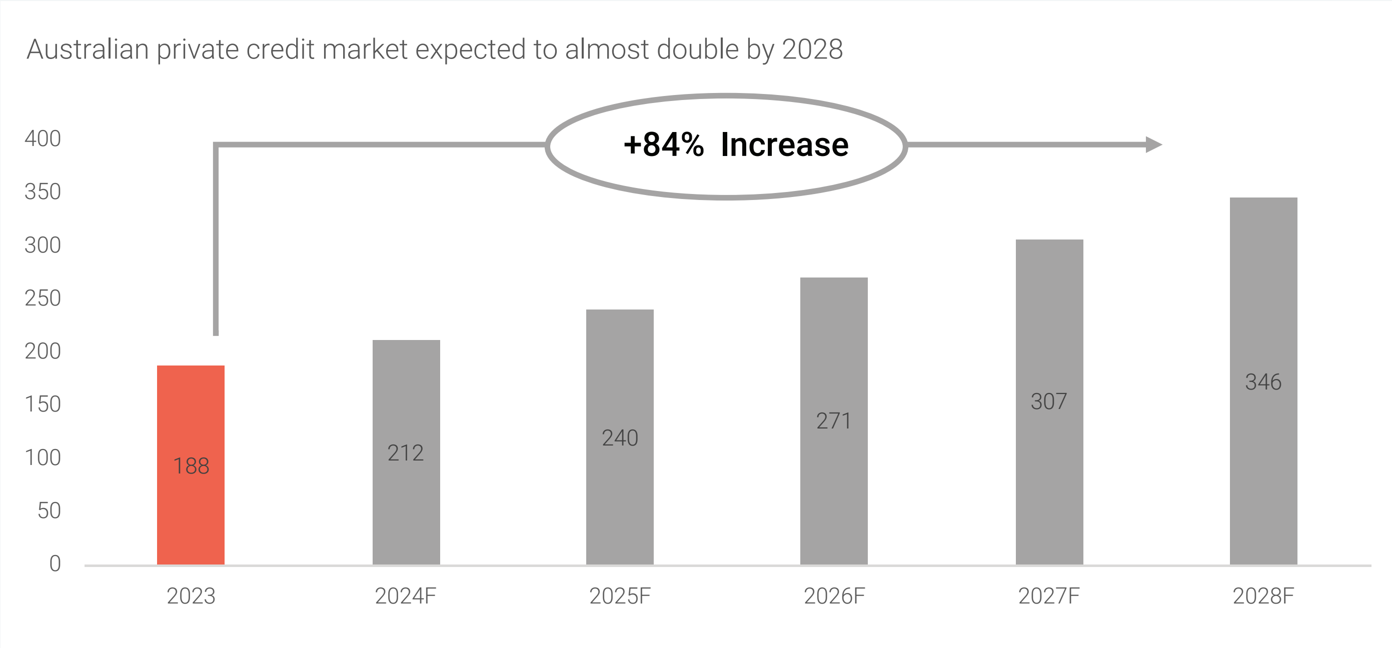
Additionally, as interest rates have increased, borrowing costs for many businesses have also risen, particularly for those requiring debt facilities to manage working capital cycles or for acquisitions. These higher costs cannot easily be passed on to customers, thereby reducing profitability in a meaningful way.

RISE OF ALTERNATIVE INVESTMENT OPTIONS (PRIVATE CREDIT) & DEMISE OF ACTIVE INVESTING

The question many active fund managers would be asking themselves is, does investing in small-cap equities via an active strategy provide the long term and risk adjusted returns that make such a strategy viable? There is no simple answer to this, but I believe the following key variables are at play:

- **Alternative Investment Options (Private Credit)** – In recent years, the market for private credit has grown significantly and become more accessible to all types of investors. On the surface, the opportunity to achieve an 8-10% annual return by investing in a first mortgage debt security (secured by land and/or property) offers a compelling risk-adjusted return. As many large financial institutions have withdrawn from lending to property developers, a vacuum has been created in the market, which is now being filled by private debt funds. However, over the long term, a critical question will need to be addressed: how will investors (who are accustomed to daily or monthly liquidity) react when bad debts increase and what has been considered a relatively low capital risk exposure begins to see elements of investor capital being lost and investors seeking to quickly redeem their funds?

Australian private credit market poised for growth (A$bn)



Source – HMC Capital

- **Focus on Highly Liquid Equities** –The rise of passive funds/ETFs over the past decade (as well as very large superannuation funds in Australia) has led to a number of these products achieving significant scale. As these funds become so large they will focus on the largest and most liquid equities. As stated previously, this leads to the market capitalisation of these equities increasing regardless of valuation considerations as these funds need to invest in listed equities that have the liquidity for them to gain an exposure of a size that is somewhat material to their overall fund. Consequently, it raises the question: why would a large industry fund invest in an Australian micro-cap with a market capitalisation of just $100 million? The answer is that they typically wouldn't, due to liquidity constraints and the need to deploy capital in a manner that aligns with the scale of their funds. This focus on highly liquid equities can skew market dynamics, often to the detriment of smaller, emerging companies.
- **Closure of Active Managers** – In many cases active managers have underperformed on a relative basis as benchmarks have remained resilient, driven by the performance of the largest and most liquid equities in their respective benchmarks. As active managers have increasingly shunned these equities on a valuation basis this underperformance has become more pronounced. Over the past 12-months we have witnessed the closure of several highly regarded small cap managers. When these funds close, their holdings are sold and proceeds returned to investors. We have recently seen such selling occur in two core investments being Move Logistics (ASX/NZX: MOV) and COG Financial Services (ASX: COG), causing significant downwards pressure on their share prices.
- **Market Attrition/Consolidation** – Over the past 24 months, there has been significant takeover activity across various sectors, which we've written about numerous times. The building sector stands out, with Boral (ASX: BLD), CSR (ASX: CSR) and Adbri (ASX: ABC) all being taken over during FY24. Interestingly, these takeovers were not driven by private equity but by industry peers, who we would argue have a deep understanding of their targets' assets and the long-term value they could generate. From an IPO standpoint there has not been one listing of quality or scale in the building materials sector. Therefore, an investor looking to gain an exposure to this sector, particularly given its longer-term tailwinds, now has even fewer ways to do this on ASX.

INVESTMENT PORTFOLIO PERFORMANCE SUMMARY

Investment Portfolio	Q4 FY24 Performance	1 Year Performance	3 Year Performance (p.a.)	5 Year Performance (p.a.)	Inception Performance (p.a.)
NCC Investment Portfolio Performance*	-14.18%	-26.49%	-14.45%	-1.58%	+5.28%
S&P/ASX Small Ordinaries Accumulation Index	-4.46%	+9.34%	-1.55%	+3.70%	+5.09%
NAC Investment Portfolio Performance*	-19.01%	-27.98%	-15.20%	+2.05%	+6.28%
S&P/ASX 300 Industrials Accumulation Index	+0.11%	+17.70%	+5.93%	+7.00%	+7.71%
NSC Investment Portfolio Performance*	-15.89%	-22.93%	-12.30%	+1.85%	-1.30%
S&P/ASX Small Ordinaries Accumulation Index	-4.46%	+9.34%	-1.55%	+3.70%	+4.31%

*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 June 2024. 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 June 2024)
Big River Industries	ASX: BRI	>20%	$116 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.

	ASX Code	NAOS % Ownership	Market Cap
BSA	ASX: BSA	>20%	$53 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.

	ASX Code	NAOS % Ownership	Market Cap
COG Financial Services	ASX: COG	>20%	$219 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.

	ASX Code	NAOS % Ownership	Market Cap
Saunders International	ASX: SND	>20%	$95 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.

	ASX Code	NAOS % Ownership	Market Cap
MaxiPARTS	ASX: MXI	5-20%	$108 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 30 June 2024)
MOVE	MOVE Logistics	ASX/NZX: MOV	5-20%	$37 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%	$21 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%	$12 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%	$194 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

ASX: MXI

Trading Update

MXI provided an update to its FY24 expectations for both revenue and Net Profit Before Tax. Relative to our expectations, the update was softer than anticipated. After excluding revenue associated with ATSG as a customer (which will reduce to $0), the core MXI truck parts business is expected to grow revenue by approximately +6%, compared to around +12% in 1H FY24. MXI has seen a noticeable slowdown in customer activity, mainly from clients on the Eastern seaboard. We believe these clients would be more exposed to the slowdown in underlying economic activity and are exposed to industries more affected by prolonged higher interest rates, such as construction and logistics. MXI also stated that competitor pricing had recently become more inconsistent, with competitors under pressure to keep or win new clients even by offering products at very low margins.

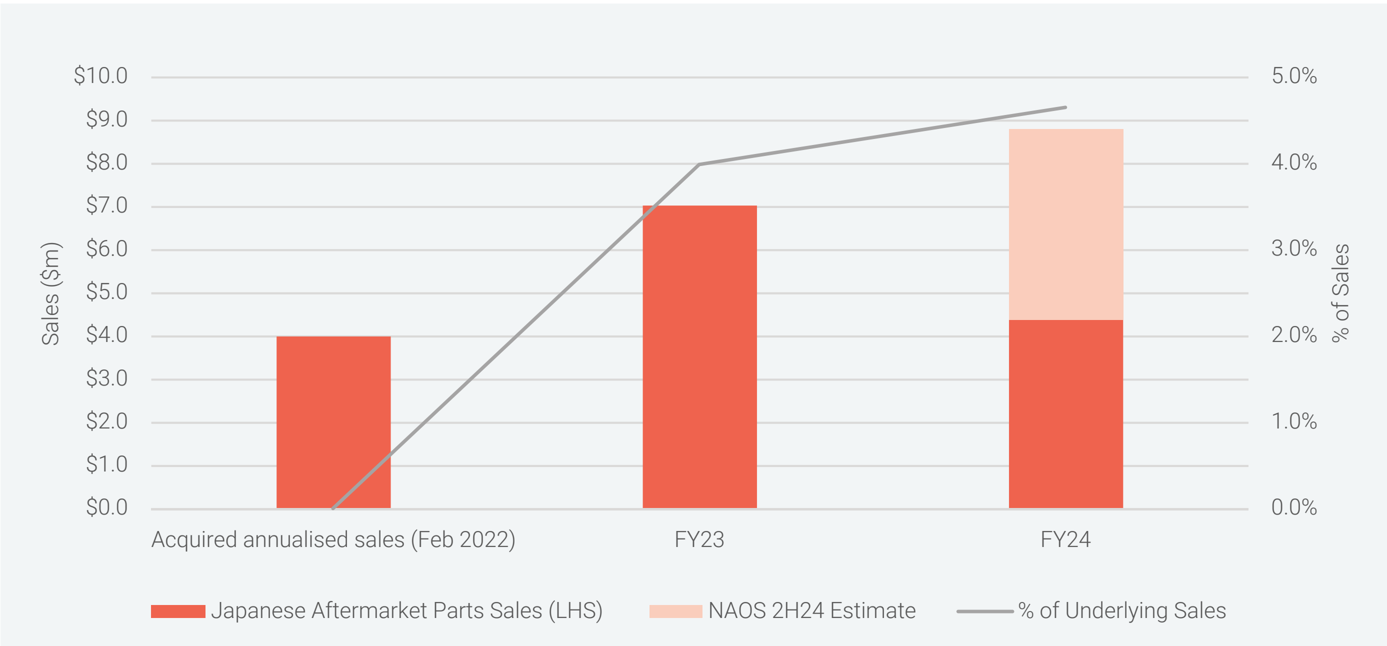
From our perspective the revenue result was not the major disappointment, considering the economic backdrop. More concerning was the margin profile of the business, which again has failed to see any notable improvement, in fact margins at the NPBT level reduced. MXI cited several headwinds such as cost pressures (salaries, integration costs etc.) which the business has been unable to offset via price increases.

Despite the business scaling significantly (expected to approach $300 million revenue in FY25), MXI has yet to achieve EBITDA margins above 10%. This is in contrast to listed peer Supply Network Limited (ASX: SNL), which has EBITDA margins closer to 17% with a similar revenue profile. Management has expanded the MXI network significantly and also entered into a number of new lease extensions, increasing the depreciation and interest expense profile significantly, essentially offsetting any operational margin gains.

While MXI's margin levels are unlikely to reach those of SNL due to a significant difference in the type of parts sold, we do expect MXI to be able to increase EBITDA margins by 2-4% (bringing group margins closer to 11-13%) over the next 3-years. This improvement should be driven by the following factors:

- **Japanese Parts** – MXI is currently rolling out a national Japanese aftermarket parts program, offering customers similar or even superior quality parts compared to OEM-branded parts, but at a lower cost. These parts offer a superior gross profit margin profile, potentially boosting the overall group gross profit margin as customer acceptance grows. Currently, sales as a % of total sales are still quite low at circa 5%, as depicted in the below graph, but our expectation is that this should increase steadily over time.

Japanese Aftermarket Parts - Sales

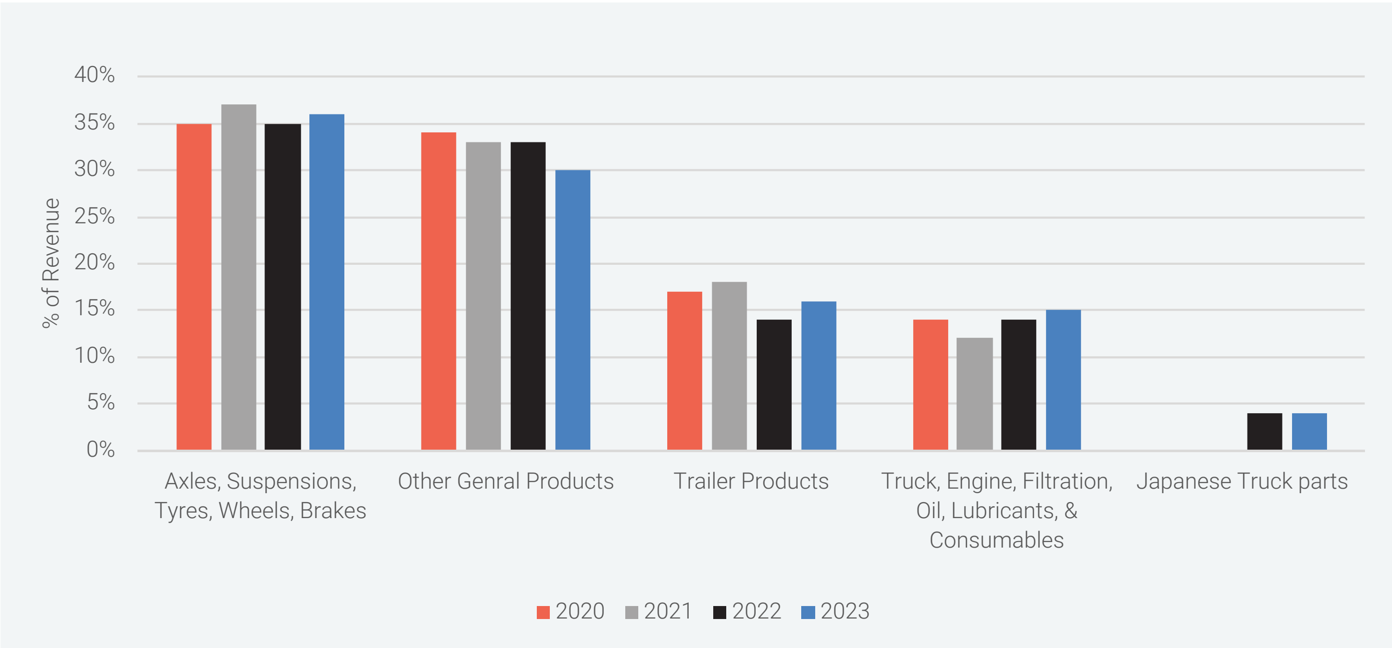


Source – MaxiParts, NAOS

- **Forch Division** – Forch products have significantly higher margins than traditional truck parts but, like the Japanese aftermarket parts, currently only form a small part of MXI's total revenue. We believe the Forch business is growing revenue at >25% p.a. but due to significant investment into sales staff, profitability has been held back. With its main competitor Wurth estimated to have Australian revenues exceeding $170 million, the potential upside for MXI is significant, especially given cross-selling opportunities to the existing MXI customer base.
- **Front of Truck** – MXI's roots are based in manufacturing truck trailers, meaning its parts business is highly exposed to truck parts associated with the trailer, and not the front of the truck, i.e. the engine. As the parts associated with the trailer are more generalised and easily interchangeable, they command a lower margin compared to parts associated with the front of the truck. A greater focus on front of truck parts provides a higher margin opportunity moving forward but as shown in the below graph, sales to the lower margin product like axles, suspensions, tyres, wheels and brakes still make up 35% of overall sales.
- **European Parts Exposure** – MXI has minimal exposure to parts for European-made trucks, which command a higher gross profit margin, similar to Japanese aftermarket parts. Given many large fleet operators prefer European trucks due to their lower fuel consumption, this represents a significant market opportunity that MXI currently lacks exposure to.

FY24 has clearly not gone to plan for MXI, at least from a financial results perspective. The company has spent the last 24 months untangling itself from its former trailer business and has undertaken three acquisitions, two of which were funded through equity raises. We believe MXI has the potential to grow EPS for many years to come and to be an excellent free cash flow generating business. However, in FY25 the board and management need to demonstrate the ability to grow EPS, not just absolute EBIT and EBITDA through acquisition, or MXI risks remaining a low P/E business for the foreseeable future.

MXI Revenue by Product Group



Source - MaxiParts

URBANISE.COM

urbanise

ASX: UBN

Entry into Expanded Strata Market Opportunity

In Q4 FY24, UBN provided an in-depth update on its Horizon 3 strategy, aimed at driving long-term, sustainable growth by leveraging the footprint of strata lots and facilities users on the UBN platform. Urbanise has been working on integrating and automating solutions to enhance the connection between strata management and their respective service providers. Currently, UBN connects with thousands of individual strata managers, who often manage hundreds of individual strata lots. These lots require services from various external service providers such as insurance providers, financial institutions, and numerous maintenance providers (plumbers, builders etc.).

This integration provides a significant opportunity for UBN with a relatively low amount of risk because:

- The solution is an add-on, not a new, unproven software platform;
- It will target the current user base;
- Data will be shared via secure APIs, eliminating the need for manual processing with multiple service providers; and
- This is an existing and proven market, with some of UBN's peers offering similar but outdated and non-cloud-based solutions, which limits their scalability.

This new service will leverage the current UBN infrastructure without requiring significant one-off capital expenditure or a significant ongoing increase in the fixed cost base. We have long stated that UBN has industry leading software and a cost base to support it, but has lacked a revenue base that reflects the significant investment in software development over many years.

UBN estimates the size of this market opportunity to be between \$30-\$45 million, based on the assumption that approximately \$20 billion of strata-related transactions occur annually, with a fee of 0.14%-0.30% applied to these transactions. This fee is comparable to what other service providers charge for similar solutions, although we would argue that UBN's technological solution is superior.

Although UBN is yet to secure a deal with a major service provider, it has stated it has generated leads and targeted opportunities with strata managers. Under the assumption that UBN can capture a 10% market share relatively quickly, with a 0.20% transaction fee, this would imply an additional \$4 million of Annualised Recurring Revenue (ARR). UBN have previously stated that they expect to be FCF breakeven within FY25 (excluding horizon 3), so if the above was to occur we would expect UBN to move well into profitability. This would position UBN to grow its sales base in a more sustainable manner. If the business can execute successfully on this opportunity, in our view the valuation applied to UBN could potentially be 4-7 times ARR.

BIG RIVER INDUSTRIES

ASX: BRI

Trading Update

BRI issued a trading update for the 9-months to March 2024. Revenue was $308 million with EBITDA of $25 million, representing a margin of 8.1%. For the sake of comparison, in FY23 BRI delivered $449 million of revenue and $51.5 million of EBITDA. In our view, despite Q3 not representing a true annualised run rate (due to January trading and Easter in late March), this was a disappointing trading update given the record result achieved in FY23.

FY24 has been the year where many headwinds converged to create what we believe is a trough in performance, and not reflective of BRI's long-term earnings potential.

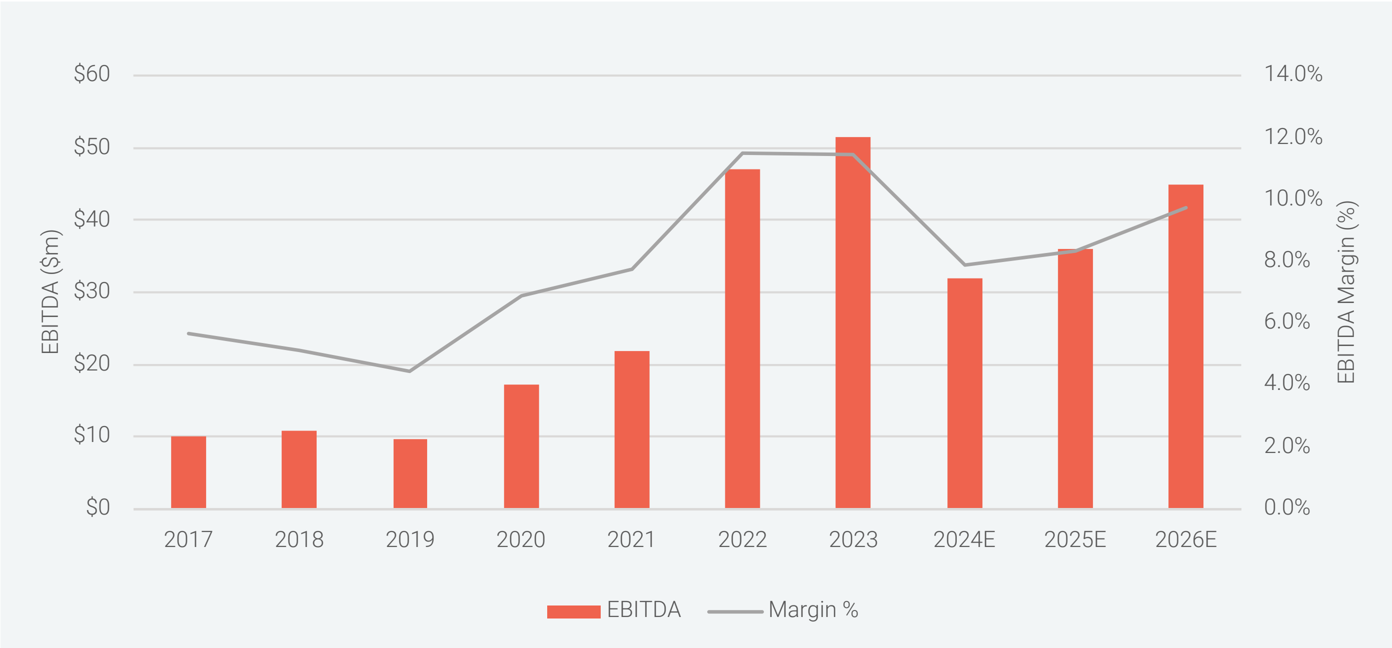
- **Residential volumes slowdown** – With over 40% of its revenue derived from residential construction the slowdown in volumes has affected BRI. Frame and truss plants, which are at the front end of the building cycle were hardest hit due to their fixed cost structure and reliance on volumes. We believe builders are still elongating orderbooks to manage volumes and match available resources better. This is highlighted by the fact it takes approximately 50% longer to build a home, increasing from 8.3 months in 2019 to 12.2 months in 2022.
- **Gross margin pressure** – Industry feedback suggests several private competitors are holding higher than normal levels of certain products, leading to pressure on gross margins as these competitors seek to maintain volumes by reducing prices in a weaker market.
- **Delays in commercial activity** – Despite a significant pipeline of commercial projects, such as works associated with the Brisbane Olympics and circa 19 hospitals due to be built around the country, delays have plagued many of these projects, and left suppliers such as BRI with orderbooks but nowhere to deliver these orders.

Despite these challenges, we still believe the long-term outlook is very strong for BRI due to the following factors:

- **Ability to improve gross margins** – With continued growth in scale and improved sourcing and processes, BRI should be able to incrementally grow its gross margin which will have a meaningful impact. Leading this charge is recent hire Gareth Watson, who previously worked at Dulux Group.
- **Unique exposure to Panels and Laminates** – Through Timberwood Panels, BRI has a strong presence in the market for architectural-grade panels and veneers. This is a large market but one where Metcash and Bunnings do not operate. It also has a more attractive margin profile and a diverse client base spread across the building industry.
- **Fixed cost leverage** – As a distribution business BRI has a significant amount of fixed cost leverage and given the current record low levels of construction approvals, the EBITDA margin is being impacted by the high cost base of the business. However, once the current slowdown in the sector reverses, any upside to revenue will flow through to EBITDA at a much higher rate.
- **Structural tailwinds associated with housing shortage** – Australia is not building enough houses to fill the current housing shortage, let alone keep up with the growth in population. As new housing activity recovers, this will provide BRI with a significant positive industry tailwind.

It will be interesting to see how BRI fared in Q4 FY24 and what, if any, outlook is provided at their FY24 results. EBITDA margins are on track to be ~2% below management's through-the-cycle target. A reversion to the 10% target would imply an EBITDA uplift of approximately ~27% prior to any revenue growth. Provided management can continue to execute successfully to ensure operational efficiency, meet customer needs and pursue strategic bolt-on acquisitions, we believe BRI will become a better and more valuable business.

Big River Historical and Forecast EBITDA & EBITDA Margin



Source – Big River Industries, FY24-26 consensus estimates

MOVE LOGISTICS

ASX/NZX: MOV

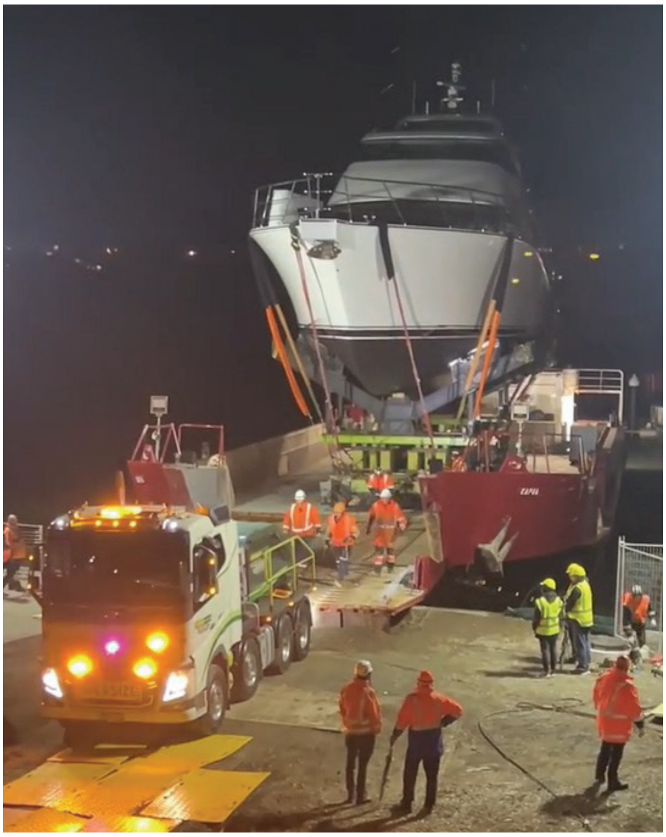
Confirmation of Previous Guidance

It is worth noting given the very poor share price performance of MOV over Q4 that the business provided a brief company update as well as a trading update. From a trading perspective the company stated, "MOVE continues to expect 2H24 Normalised EBITDA to be ahead of 1H24." Given the 1H24 result of $13.2 million at the EBITDA level and a -$8.6 million EBIT loss, the bar for an improvement is somewhat low. However, considering just how soft the macro backdrop in New Zealand is we believe any significant improvement, such as EBITDA of >$16 million in 2H24 would be a highly regarded outcome.

MOV also announced a slightly amended strategy for their Oceans division. To give the division further scale, increased reliability and align with MOV's transition to an asset-light model, the company will enter into a time share agreement for a significantly larger and newer vessel.

Clearly there will be plenty of focus on the FY24 result for MOV, with a key aspect being the balance sheet position along with the 2H trading. However, should the New Zealand economy transition as expected from a period of contraction to expansion over the next 12 months, we believe MOV could be well-positioned to benefit from its recent strategic efforts, leading to improved margins compared to historical standards.

As we have stated previously, we believe MOV is in a unique position with a network presence that stretches across the entirety of NZ catering for both FCL (Full Container Load) and LCL (Less than Container Load), providing a strong moat. In addition, MOV also has a specialist division which can move large infrastructure-related items (such as wind turbines) or other large one-off items, such as the 114ft super yacht weighing 110 tonnes, shown in the picture opposite.



Source – Move Logistics

In mid-July, MOV announced the resignation of CEO Craig Evans. This was unexpected, but we believe the executive team has the calibre to execute on the stated strategy without him at the helm. We also believe that with the improvements made to date MOV should be able to promote or recruit a high calibre CEO once again.

BSA LIMITED

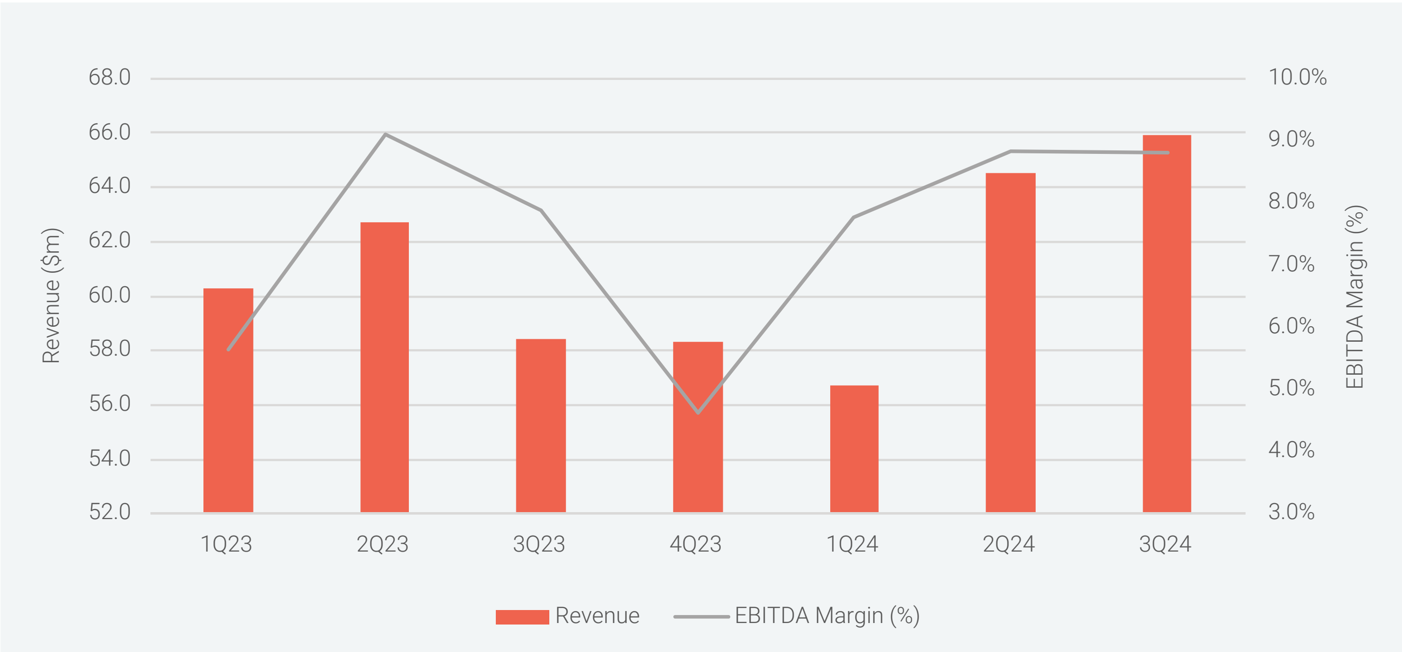
ASX: BSA

Quarterly Trading Update

Finally, BSA released its Q3 Activities Update which highlights the momentum the business currently has, after many years of hard work. For Q3 FY24, EBITDA was $5.8 million, implying an annualised run rate exceeding $23 million, a remarkable outcome given the company's position just 24 months ago.

With BSA holding a significant amount of tax losses we expect the EBITDA to NPAT conversion to be relatively high and therefore place BSA in sound shape to internally fund the final payment associated with the class action settlement made approximately three years ago. Once this payment is made, the free cash flow generated will provide BSA with far greater optionality in terms of M&A, capital management, and other strategic initiatives.

BSA - Revenue & EBITDA Margin



Source – BSA, NAOS


NAOS
SUMMARY

SUMMARY

There is no hiding from the fact that the Q4 performance and the FY24 performance as a whole has been far from satisfactory and nowhere near the standards we set ourselves. Directors, staff, family and friends represent some of the largest investors across all the NAOS LICs, so the poor performance has a direct and meaningful impact.

I remain steadfast in my belief that we can not only restore value for all shareholders but also achieve the long-term returns that we had been able to produce just a few years ago. The key reasons I remain so confident in this belief are as follows:

- **Low Earnings Multiples** – Many of our core investments are trading on very low earnings multiples based on both FY24 and FY25 earnings expectations. Businesses such as Big River Industries (ASX: BRI) and COG Financial Services (ASX: COG) are trading on less than 12 times NPATA and 9 times NPATA respectively. Such valuation multiples would imply no earnings growth is expected over the next 1-3 years if not longer.
- **Dividend Yields** – The strong cash generation of most of our core investments, coupled with the aforementioned low earnings multiples, implies an attractive dividend yield. As an example, if COG can deliver $25 million NPATA in FY24 and continue with its 65% payout ratio, this implies a fully franked dividend yield of ~7.5% based on its current share price.
- **Cash Generative Businesses** – Many of our largest investments would be considered distribution or aggregation type businesses. These business models tend to have excellent free cash flow generation due to their low capital expenditure profiles and diverse customer bases. This provides the management teams and boards with ample flexibility to allocate capital to the highest returning propositions.
- **Potential Earnings Growth** – We invest in a business because we expect long-term earnings growth to play a significant part in our overall investment return. So even though the likes of MXI and BRI will see EPS fall in FY24, we do not believe this is the start of a trend nor reflective of their long-term earnings potential. In the case of MXI, we believe EPS could increase by ~50% over the next 24 - 36 months as margins move closer to those of peers. For BRI, we believe should margins return to the 10% long-term average and revenue growth normalises, EPS growth of >40% over 3-years is not inconceivable.

FY25 will be a significant year for many, if not all, of our investee companies as both management and the boards of our investee companies understand the need to restore value for all shareholders and identify sustainable strategies for long-term growth. We have continued to seek representation at a board level on our investee companies, most recently with the appointment of a NAOS representative on the board of MXI. We now have a NAOS representative on the boards of many of our core investments and we continue to believe we are well placed to have significant input on matters that can drive long-term value for all shareholders.

As always if any shareholder has any concerns or suggestions, please do not hesitate to contact me directly on (02) 8064 0568.

The NAOS team appreciates your continued support especially in these trying times.

Kind regards,

Sebastian Evans

Managing Director and Chief Investment Officer
NAOS Asset Management Limited

NAOS

Certified B Corporation

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