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Auscap Newsletter

OCTOBER 2024

AUSCAP ASSET MANAGEMENT LIMITED

On The Road Again – Recent Company Visits Across Australia, the US and the UK

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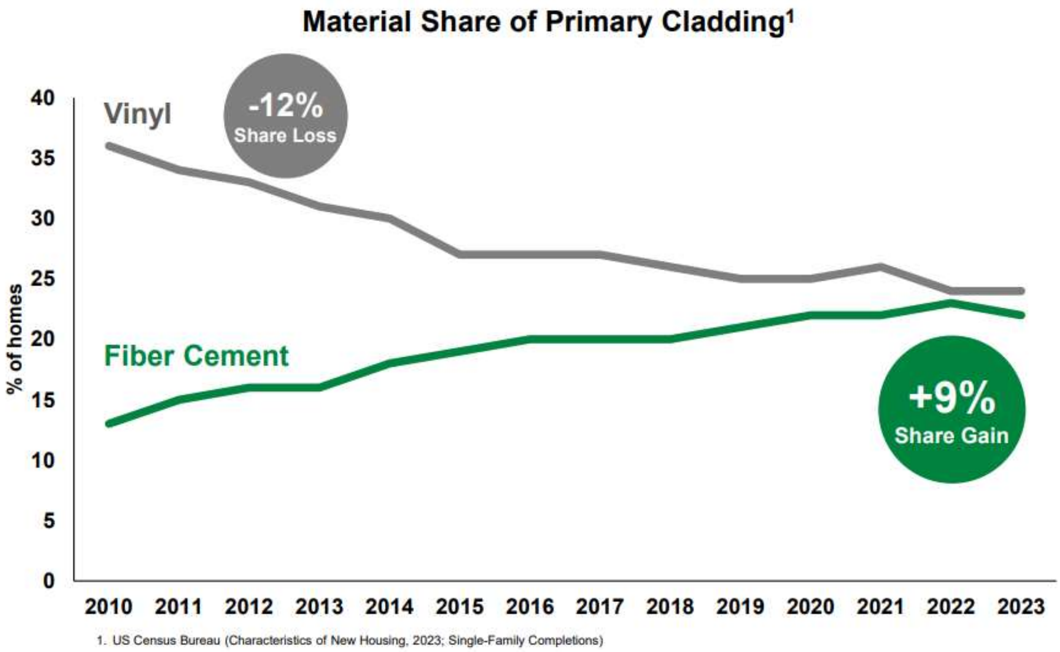
Outside of the reporting seasons in August and February, Auscap's investment team spend much of the year on the road visiting the operations of current and potential investments both within Australia and abroad. The last few months have been no different, with the team undertaking multiple trips across North America, the United Kingdom and around Australia. This newsletter covers a few highlights from these recent trips.

James Hardie (JHX) – United States Operations & Distribution

James Hardie is the largest global manufacturer of fibre cement, with primary geographic end markets across North America, Europe, Australia & New Zealand. Fibre cement is a composite building and construction material, used mainly in facade and roofing products because of its strength and durability.

James Hardie distribution showroom promotional material, Jersey, USA. Source: Auscap

James Hardie estimates it has a 90% share of fibre cement in its key market of the United States of America (US). The product has consistently been taking share as a housing cladding substrate from other alternatives such as vinyl, brick and wood. Fibre cement is cost competitive with vinyl, whilst having superior aesthetics as well as better fire, pest and weather resistance qualities.



Source: James Hardie

In June 2024, we attended the James Hardie Investor Day across Washington and New York, where we met with James Hardie management, distributors and customers. The James Hardie fibre cement product created an attractive exterior for the many homes we saw the various fibre cement products applied to.

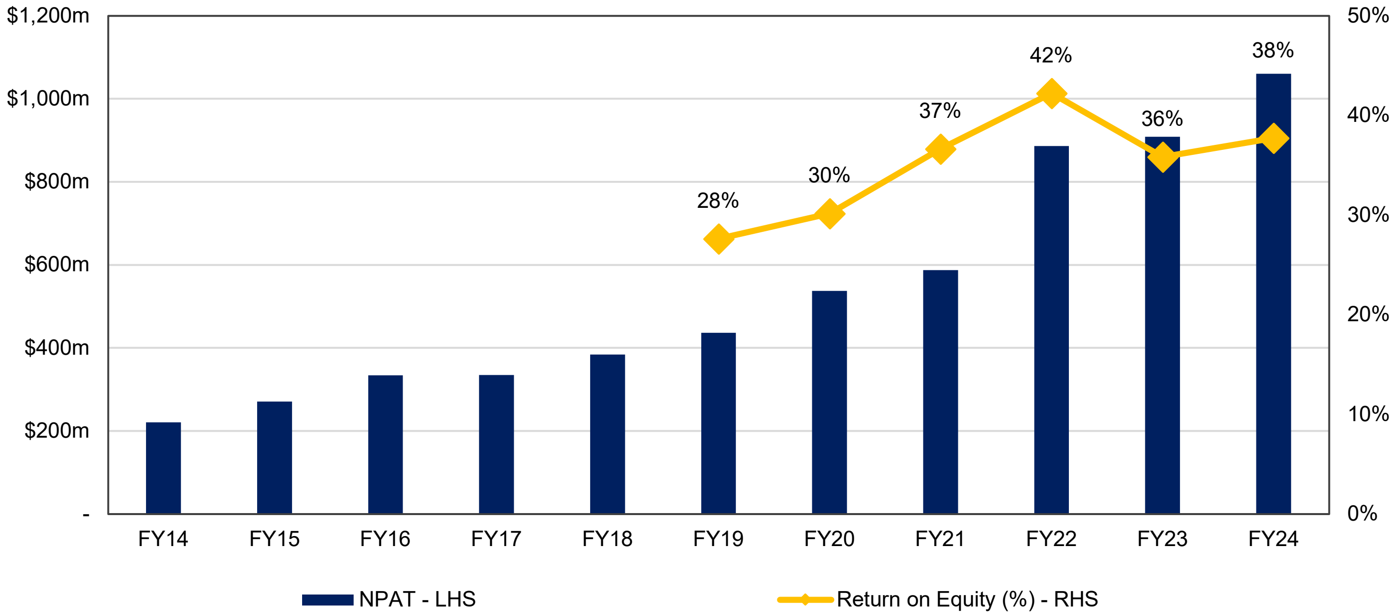
James Hardie fibre cement clad homes, Washington DC, USA. Source: Auscap

The contrast to vinyl product was noticeable. The vinyl offering was relatively flimsy, demonstrated by the compression that would occur when a small amount of pressure was applied, as shown in the photos below. Further, vinyl is highly combustible, not resistant to extreme weather events such as hailstorms, not pest resistant and has a less desirable external appearance. It is not difficult to see why James Hardie is the predominant hard siding of choice for 24 of the largest 25 builders in the US.

Competing Vinyl exteriors with pressure applied, which fibre cement has been displacing. Source: Auscap

James Hardie's strong market position and structural growth have driven a long history of solid earnings growth at very high returns on capital, albeit with some cyclicality, largely driven by James Hardie's exposure to housing construction cycles. This track record of earnings growth over time can be seen in the chart below.

James Hardie Financial Track Record



Source: FactSet, Auscap. Return on Equity not applicable from FY14-18, as net assets were negative.

We came away from the Investor Day confident in the continued market share opportunities for the company and impressed by James Hardie's management depth and research and development capabilities. Management reiterated their commitment to achieving long-term revenue growth and margin expansion at high returns on capital.

Nick Scali (NCK) – United Kingdom Acquisition

Nick Scali has been a long-term holding. We are enthusiastic about Nick Scali's dominant market position, track record of strong execution, market leading financial metrics, growth outlook and valuation. In April 2024, after many years of analysing the United Kingdom (UK) furniture market, Nick Scali announced the acquisition of Fabb Furniture (Fabb), a loss-making furniture retailer with 21 stores, to gain a reasonable initial store network. Nick Scali has approached its UK expansion in what we perceive to be a low-risk manner. They paid just £2 for the equity of the Fabb Furniture business, raising $50m from investors to pay down the business' debt and fund the immediate working capital requirements and broader UK expansion plans, including store refurbishments, store rebrandings and marketing.

We are positively disposed to the transaction. The establishment of the Nick Scali brand in the UK through the acquisition of Fabb has some parallels with Nick Scali's successful 2021 acquisition of Plush Furniture. Nick Scali has an opportunity in the UK to put forward a differentiated product offering, significantly increase gross margins and grow sales per store compared to Fabb's historic metrics. The market has many similarities to Australia, such as the cultural characteristics, acceptance of made to order furniture and bricks and mortar retail environment for upholstery and case goods. But the UK population is two and a half times larger than Australia, leading to the biggest furniture retailers in the UK achieving store productivity metrics well above Australia. Sector leader DFS achieves revenue per store more than triple Nick Scali in Australia, with Fabb currently achieving roughly half of Nick Scali's revenue per store despite often being in the same retail parks as DFS. In addition, should Nick Scali gain confidence in their likelihood of success in the UK, we see significant opportunity for potential expansion towards 50 to 100 stores. We think the acquisition was made on attractive terms at a sensible time in the cycle, with the business acquired after a period of difficult macroeconomic conditions in the UK which saw the Bank of England lift its "Bank Rate" to 5.25% to quell inflation. Since the acquisition the Bank of England has cut the Bank Rate by 0.25% to 5.0%, and with the UK Consumer Price Index now below the Bank of England's 2% target at 1.7%, we expect further rate cuts going forward.

Ahead of rebranding the network to Nick Scali, management are currently in the process of extensive refurbishments to the Fabb store network and replacing Fabb product with products supplied by Nick Scali's manufacturers. The Auscap investment team recently visited the majority of the Fabb store network across the United Kingdom and spent time with local management. Fabb is currently positioned as a mass market player competing with the likes of UK furniture giant DFS. However the brand is only 5 years old and hence brand awareness is low. Further, similar products to the Fabb range are sold by competitors at lower prices, creating a challenging selling proposition for staff. The latest Fabb store fitouts, executed under prior ownership, appear reasonable, however the offering as a whole leaves a little to be desired. This is evident from the external and internal appearance of the stores, as shown below. It was not difficult to see why the Fabb stores were generating very little sales in comparison to their peers.

Gavin Rogers standing outside Fabb Keighley. Fabb's "Zanzibar" 3 Seat Sofa on sale for £998 / A$1,930 (RRP£2,196 / A$4,263). Source: Auscap

Nick Scali intend to completely reposition the business upon rebranding. Nick Scali offers design-led, modern, mid-market aspirational furniture at very competitive prices relative to the quality of the furniture. We observed that spending by this demographic has proven relatively resilient and has been less affected by high interest rates in the UK.

The first store management have chosen to refurbish is Thurrock, just outside of London. This refurbishment was ongoing at the time we visited. As shown below, the store appearance will be similar to Nick Scali's Australian stores. Management have indicated that the speed of store refurbishment is expected to accelerate in coming months. It is worth noting that none of the products featured in these photos are Nick Scali style products, but instead are part of the current Fabb product range.

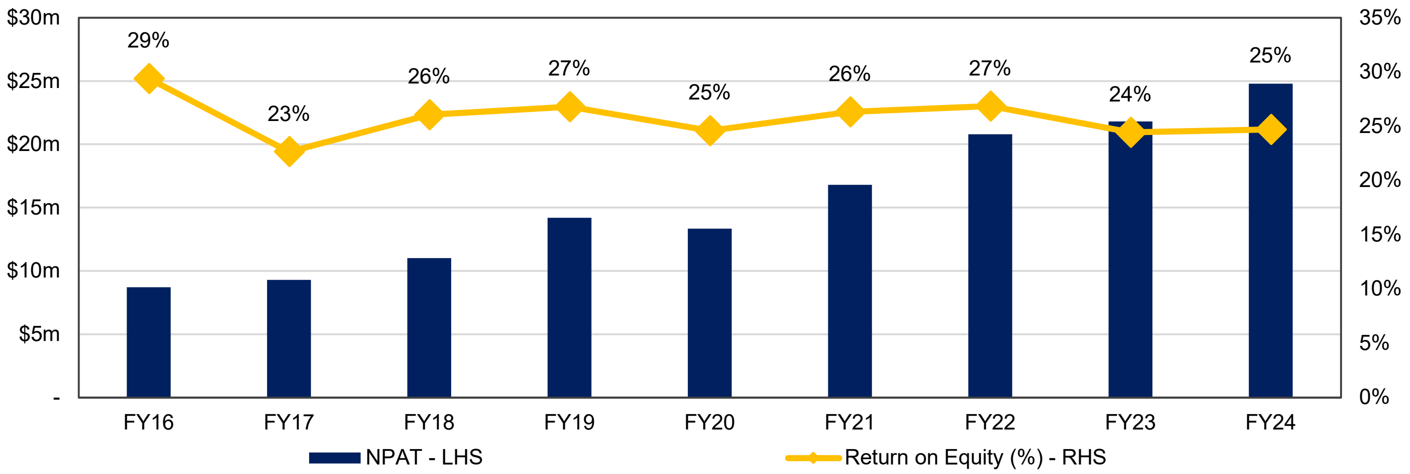
Fabb Furniture Thurrock. Source: Auscap

The company confirmed that part of the Nick Scali sofa range has recently arrived in the UK with some of the dining range expected in November. The opportunity for Nick Scali in the UK is potentially significant and we will continue to watch the UK rebranding, the customer response to the range and the refurbishment of the stores with interest.

PWR Holdings (PWH) – US and UK Operations

PWR Holdings is a global leader in all aspects of thermal management of complex cooling systems. At its 2015 IPO, PWH was known primarily for being the dominant supplier of cooling equipment to the elite motorsports sector including Formula One, with founders Kees and Paul Weel both having backgrounds as professional motorsports racing drivers. Since then, PWH has leveraged its intellectual property around these cooling systems to expand from motorsports to supply customers across the high-end internal combustion vehicle, hybrid and electric vehicle, aftermarket, aerospace, defence, renewable energy and industrial sectors. By focusing on supplying high value products in areas where PWH has technical expertise, PWH has been able to grow earnings at a double-digit rate at attractive incremental margins. PWH continues to be led by its founder Kees Weel, who is the company's largest shareholder.

PWH Financial Track Record



Source: FactSet, Auscap

Management currently have ambitions to double the revenue of the business within the next 5 years, with the largest sources of potential incremental revenue being in aerospace and defence, sectors with huge addressable markets in which PWH believe they are currently just scratching the surface. As a result of this growth opportunity, management are expanding their South East Queensland manufacturing presence and are also expanding their manufacturing base at both Rugby in the West Midlands of the UK and Indianapolis in the US. The scale of this investment led to PWH announcing a softer than expected margin outlook for FY25 at its August 2024 result. Auscap has visited all three of PWH's manufacturing hubs, including Indianapolis in June 2024 and Rugby in September 2024. We were impressed with the technical capabilities and progress of the expansion at these sites. We anticipate that PWH having a local presence in these markets will lead to an increase in revenue opportunities for the business over time.

The US facility is spread across two locations about 150m apart, with traditional motorsport customers serviced out of one building, and aerospace and defence serviced out of the other. The facility has been set up to produce cold plates, which are used in applications like battery and electronic cooling. At the time of the visit the facility was still in testing for some of the equipment, such as the vacuum brazing furnace seen in the centre of the picture below (bottom right). While PWH is well known in professional motorsports, there is relatively low recognition of the brand outside of this market, with significant opportunities across all verticals to change this in the enormous US market.

PWH Facility in Indianapolis, USA. Source: Auscap

The UK facility has been designed with a motorsports and aftermarket focus. However, it seems logical that there will be continued expansion at this facility to cater for demand in the aerospace and defence sectors servicing European clients. There appears to be significant capacity at this facility, with plans for a new vacuum brazing furnace, anodising plant and heat treatment furnace to be installed in the next few years so that PWH can produce liquid cold plates in the UK. PWH has more than doubled the number of people working at the facility in the last 12 months or so to approximately 60, with capacity to cater for 120 full time staff.

PWH facility in Rugby, UK. Source: Auscap

As the expansion of PWH's facilities are completed over the coming years, we expect the company to deliver strong earnings growth and high returns on capital driven by the increasing demand for cooling systems in each of their key markets.

Qube Holdings (QUB) – Sydney & Port Kembla Assets

Qube is Australia's largest integrated provider of import and logistics services. Its business has three key parts:

- Qube Operating Division – Logistics and Infrastructure: an Australian national supply chain offering mainly focused on containerised import/export cargo, automotive multi-user terminals and bulk grain terminals. It has a diversified end market presence across the automotive, agriculture, consumer, industrial and resources markets. This division includes an investment in the Moorebank Logistics Park Intermodal Rail Terminals which forms part of Australia's largest intermodal logistics precinct.

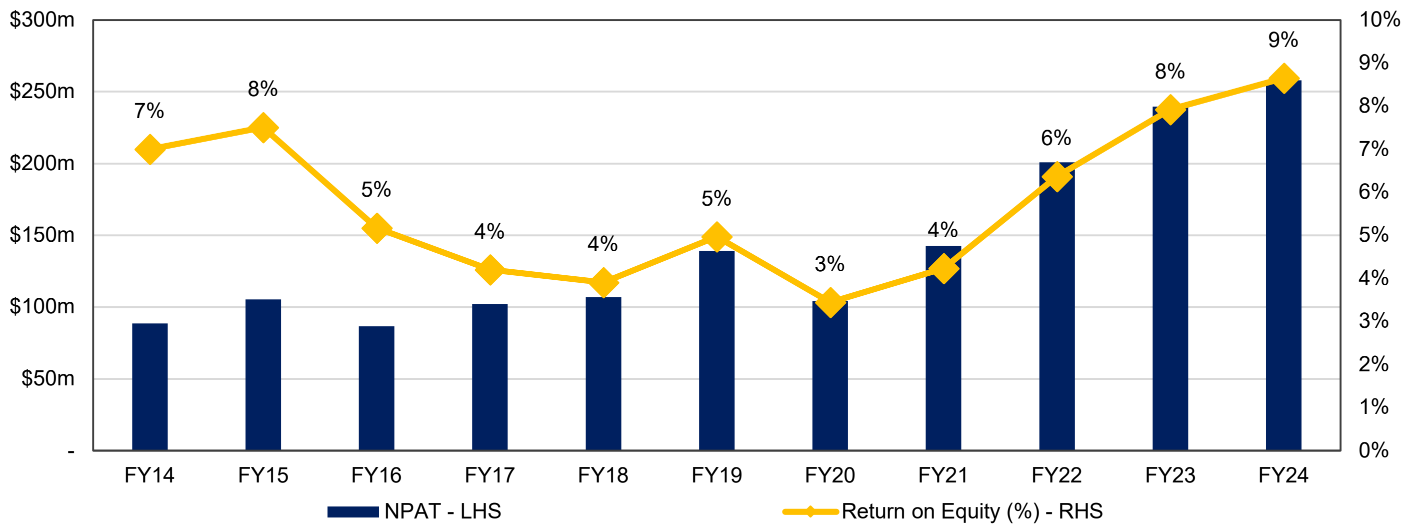
- Qube Operating Division – Ports and Bulk: provides a broad range of logistics services for the import and export of largely non-containerised freight. This division has a diversified end market presence mainly across forestry, automotive, mining and energy.

- Patricks Terminals: a 50% shareholding (other 50% owned by Brookfield) in one of the two major Australian national container stevedoring operators, with over 40% market share. Patricks Terminals operate on long-term leases at the four largest Australian container ports: Port Botany (Sydney), Fisherman Island (Brisbane), Melbourne & Fremantle.

Qube has built or acquired an asset network across more than 200 locations over almost two decades that we doubt could be replicated. The business has achieved respectable mid-single digit earnings per share growth over the last decade, albeit the business' record of heavy investment has weighed on return on capital metrics. Qube currently has an unusually high $718m of capital employed into projects that are yet to fully ramp up. Some of this investment is now paying off, with the significant Moorebank IMEX Terminal now cash flow breakeven, and on track to achieve EBITDA north of $80 million at scale (inclusive of earnings from related ancillary activities). Qube has also flagged upcoming opportunities to divest assets that are generating minimal or negative earnings at attractive valuations.

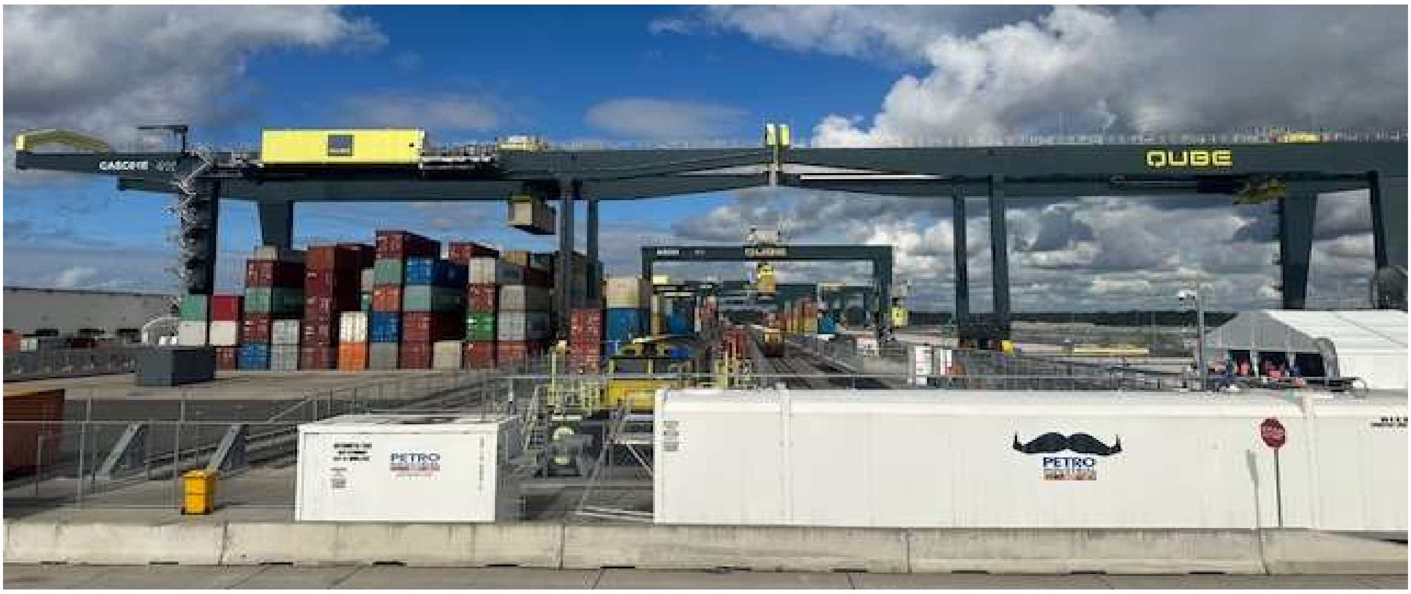
At the August 2024 result, management noted that they are on track to hit their 10% return on capital employed target and are sufficiently confident to upgrade this target to 12%+ over the medium term.

Qube Financial Track Record



Source: FactSet, Auscap

In May 2024, Auscap visited a number of Qube's assets in Sydney and Port Kembla. We were impressed with the scale of the Moorebank Logistics Park, which had only recently commenced operation at the time of the site visit, with all signs suggesting the ramp up is progressing strongly.



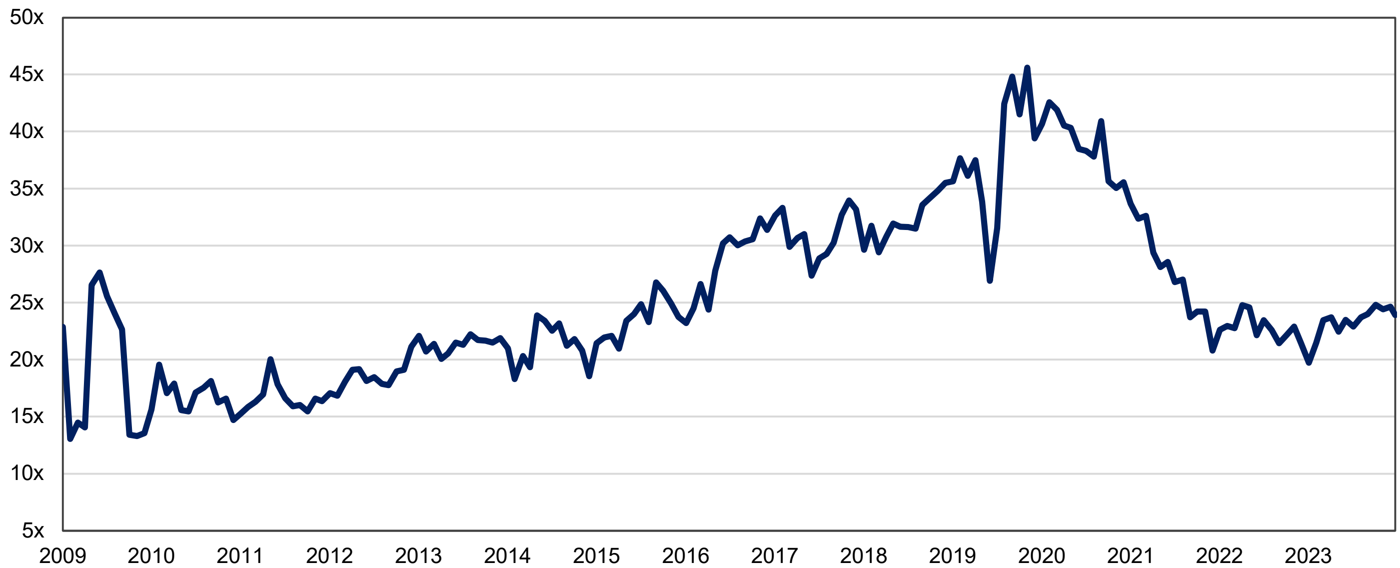
Moorebank Logistics Park. Source: Auscap

Whilst not financially material, we were also impressed by Qube's vertical integration within its Agriculture business, with its new grain trading presence supporting the capacity utilisation of its infrastructure.

Qube's grain storage facilities, Port Kembla. Source: Auscap

Qube's critical infrastructure, diverse end markets and ramp up of capacity utilisation will position the business well to continue to perform strongly over the economic cycle. Qube is trading near the bottom of its P/E multiple valuation range over the last decade, which we view as attractive, particularly if it can achieve its return on capital targets.

Qube Price / Next 12 Months Earnings (P/E) ratio



Source: FactSet, Auscap

Auscap Long Short Australian Equities Fund

Fund Performance*

Period	Auscap	All Ords
September 2024	3.2%	3.4%
Financial Year To Date	9.1%	7.9%
Since Inception (Dec 2012)	445.9%	204.8%
Annualised Returns	15.4%	9.9%

Fund Exposures

September 2024 Average	% NAV	Positions
Gross Long	96%	35
Gross Short	0%	0
Gross Total	96%	35
Net / Beta Adjusted Net+	96%	103%

Portfolio Commentary*

The Fund returned 3.2% net of fees during September 2024. This compares with the All Ordinaries Accumulation Index return of 3.4%.

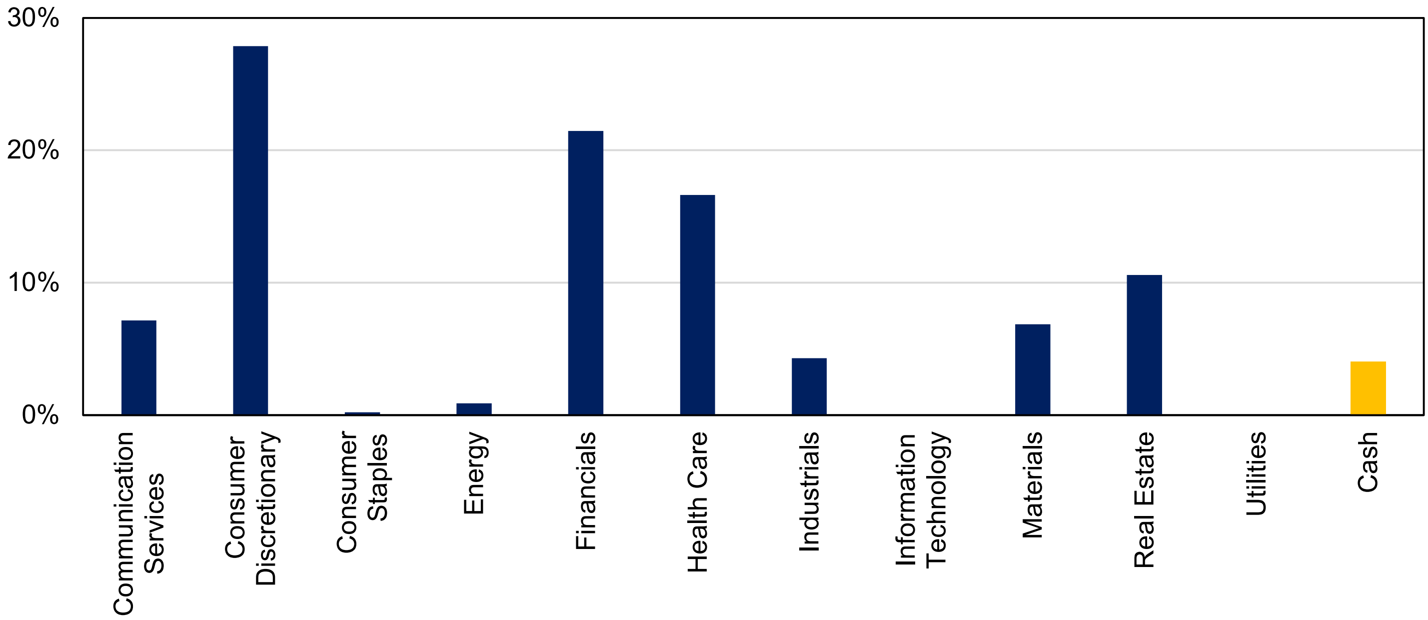
During September, consumer discretionary, materials, financials, and industrials sectors contributed positively to returns, while the communication services, health care, real estate, consumer staples and energy sectors detracted.

Over the month, Mineral Resources, Nick Scali, Eagers Automotive, ARB Corp, and Macquarie Group were the largest positive contributors to performance.

Top 20 Investments^

ARB Corp	Macquarie Group
Breville Group	Mineral Resources
CAR Group	Netwealth Group
Charter Hall Retail REIT	NIB Holdings
CSL	Nick Scali
Eagers Automotive	PWR Holdings
HMC Capital	REA Group
HomeCo Daily Needs REIT	Reece
HUB24	ResMed
James Hardie Industries	Sigma Healthcare

Sector Exposure - September 2024#



* *Performance figures are calculated for the Monthly Class net of all fees and expenses and assuming the reinvestment of all distributions. Note, as at 1 January 2021, the Series Class was consolidated into the Monthly Class. Past performance is not a reliable indicator of future performance.*

\+ *Beta adjusted net adjusts the portfolio for the beta, or share price volatility, of the stocks relative to the All Ordinaries Accumulation Index.*

^ *Top 20 long investments in alphabetical order as at 30 September 2024.*

\# *Average sector exposure during September 2024.*

Auscap Ex-20 Australian Equities Fund

Fund Performance*

Period	Auscap	Index**
September 2024	3.2%	4.1%
Financial Year To Date	8.8%	9.1%
Since Inception (Dec 2023)	22.7%	20.6%
Annualised Returns	NA	NA

Fund Exposures

September 2024 Average	% NAV	Index
Equities	97%	100%
Cash	3%	0%
Beta Adjusted Exposure+	103%	103%
Positions	51	

Portfolio Commentary*

The Fund returned 3.2% net of fees during September 2024. This compares with the S&P/ASX 300 Ex S&P/ASX 20 Index return of 4.1%.

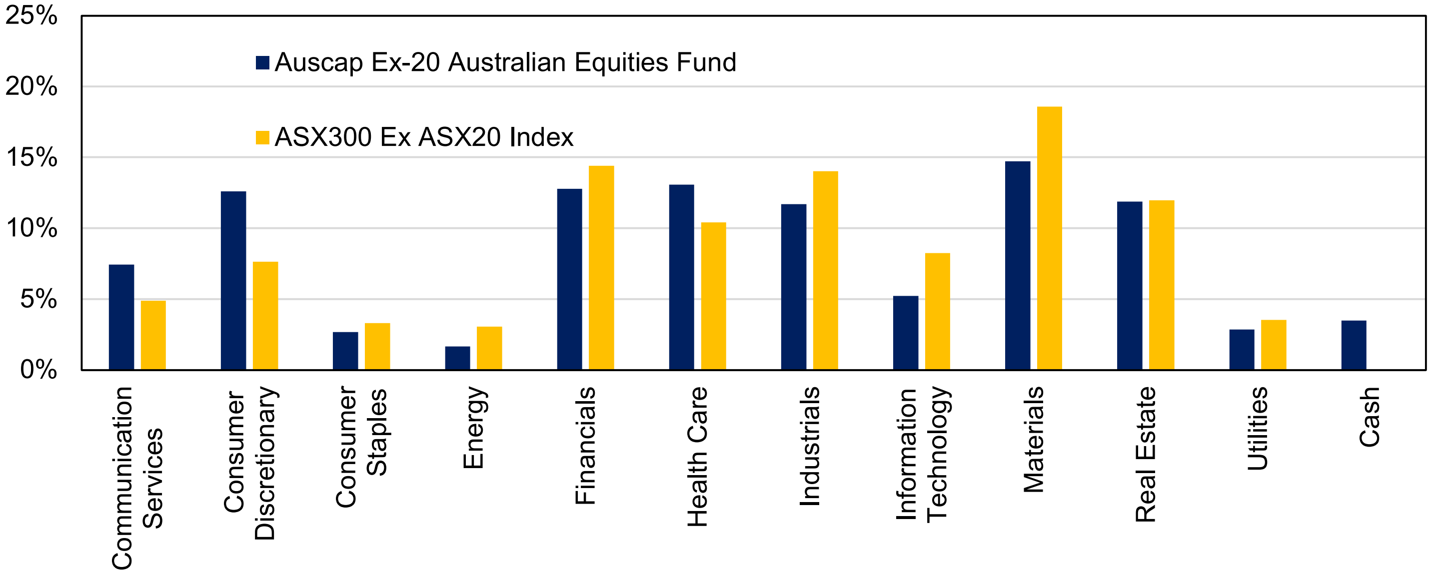
During September, the Fund's exposure to the materials, consumer discretionary, industrials, information technology, financials, energy, utilities and health care sectors contributed positively to returns. The Fund's exposure to the communication services, real estate and consumer staples sectors detracted from returns.

The Fund's holdings in Mineral Resources, Nick Scali and Wisetech were the largest contributor to returns.

Top 20 Investments^

Amcor	Northern Star Resources
CAR Group	Qube Holdings
Charter Hall Retail REIT	REA Group
HMC Capital	Reece
HomeCo Daily Needs REIT	Reliance Worldwide
HUB24	ResMed
James Hardie Industries	Sigma Healthcare
Mineral Resources	Sonic Healthcare
NIB Holdings	Wisetech Global
Nick Scali	Xero

Sector Exposure - September 2024#



* *Performance figures are calculated for the General Class net of all fees and expenses and assuming the reinvestment of all distributions. Past performance is not a reliable indicator of future performance.*
** *Index used is the Benchmark for the Auscap Ex-20 Australian Equities Fund, being the S&P/ASX 300 Ex S&P/ASX 20 Index.*
+ *Beta adjusted exposure adjusts the portfolio of the Fund and of the Benchmark (being the S&P/ASX 300 Ex S&P/ASX 20 Index) for the beta, or share price volatility, of the stocks relative to the All Ordinaries Accumulation Index.*
^ *Top 20 investments in alphabetical order as at 30 September 2024.*
# *Average sector exposure during September 2024.*

Newsletter – October 2024

Auscap Asset Management

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