

# NAOS Emerging Opportunities Company (NCC)

NAOS

## MONTHLY INVESTMENT REPORT AND NTA UPDATE

MARCH 2015

### COMPANY OVERVIEW

#### Investment Objective

NCC seeks to provide investors with exposure to high quality emerging companies in a transparent and concentrated long/short structure, with the ability to outperform the Benchmark over the medium to long term. The Company will seek to pay a minimum dividend yield of 4.00% per annum franked to the maximum extent possible. The Company has the ability to short sell securities and hold significant levels of cash to assist in protecting investor's capital.

#### Investment Process

A unique 5 step investment process that places a strong emphasis on long term industry dynamics, management team capabilities and a track record of producing significant shareholder value over the medium to long term. Finally, catalysts are identified for each potential investment so that these investments will be re-rated by the market and trade on valuations closer to their larger counterparts.

#### Investment Strategy

To actively manage a concentrated portfolio (approximately 0-20 positions) of high quality emerging companies across a wide range of industries, which investors may have a limited exposure to through investing in companies just in the ASX-100 Index. Many of these emerging companies are often overlooked and are therefore potentially inefficiently priced by the wider investment community.

**Inception Date: 26th of February 2013**

**Benchmark: Small Ordinaries Accumulation Index (XSOAI)**

**Shares on Issue (ASX: NCC): 46,918,297**

**Listed Options on Issue Exercisable at \$1.13 Prior 1st August 2015 (ASX: NCCOA): 11,789,000**

**Fully Franked Dividend Yield: 6.37%  
Gross Fully Dividend Yield 9.10%**

### Net Tangible Asset Value Breakdown as at 31<sup>st</sup> March 2015 (Post the \$0.0325 Fully Franked Dividend to be Paid on 20<sup>th</sup> April 2015)

<b>Pre Tax NTA:</b>	<b>\$1.11</b>
<b>Post Tax &amp; Pre Unrealised Gains Tax:</b>	<b>\$1.11</b>
<b>After Tax NTA:</b>	<b>\$1.10</b>

The above NTA calculations do not account for any potential dilution from the 11,789,026 NCCOA options that remain on issue (expiry 1st August 2015) and which are exercisable at \$1.13.

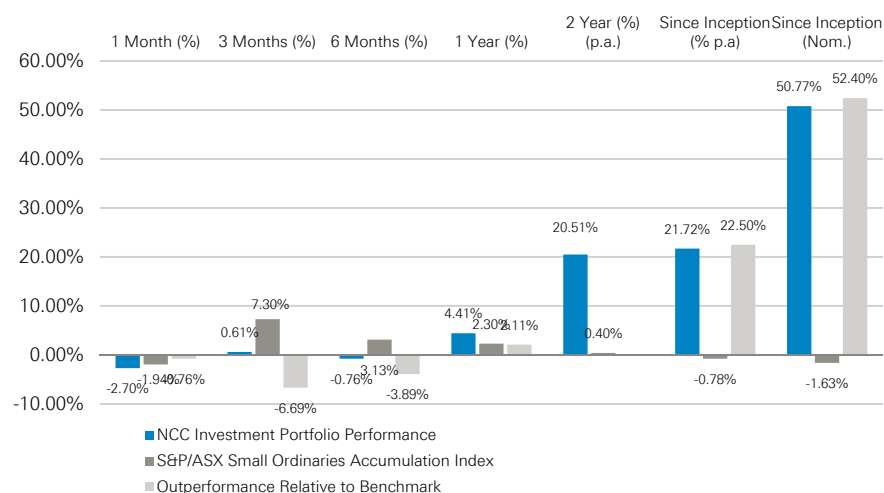
### Investment Portfolio Performance to 31<sup>st</sup> March 2015

The Investment Portfolio posted a negative return for the month of March of -2.70% compared to the Small Ordinaries Accumulation Index (XSOAI) which posted a negative return of -1.94%.

A significant amount of the portfolio's negative return was attributable to a single position which experienced a significant change to the investment thesis during the month. As a general rule, NAOS will always remove a position from the portfolio when there has been a negative change to the investment thesis, the position is removed as soon as practicable and re-analysed at a later stage. Whilst the action of removing the position from the portfolio resulted in a loss for the portfolio, we believe it is best practice to close out our exposure in order to re-assess the opportunity and in the interests of protecting investors' capital from further potential downside.

	1 month	3 months	6 months	1 Year	2 Years (p.a.)	Inception (p.a.)	Inception (Nom.)
<b>NCC Investment Portfolio Performance*</b>	<b>-2.70%</b>	<b>+0.61%</b>	<b>-0.76%</b>	<b>+4.41%</b>	<b>+20.51%</b>	<b>+21.72%</b>	<b>+50.77%</b>
<b>S&amp;P/ASX Small Ordinaries Accumulation Index (XSOAI)</b>	<b>-1.94%</b>	<b>+7.30%</b>	<b>+3.13%</b>	<b>+2.30%</b>	<b>+0.40%</b>	<b>-0.78%</b>	<b>-1.63%</b>
<b>Outperformance Relative to Benchmark</b>	<b>-0.76%</b>	<b>-6.69%</b>	<b>-3.89%</b>	<b>+2.11%</b>	<b>+20.11%</b>	<b>+22.50%</b>	<b>+52.40%</b>

\*Investment Portfolio Performance is post all operating expenses, before fees, taxes and initial IPO and placement commissions. Performance has not been grossed up for franking credits received by shareholders.

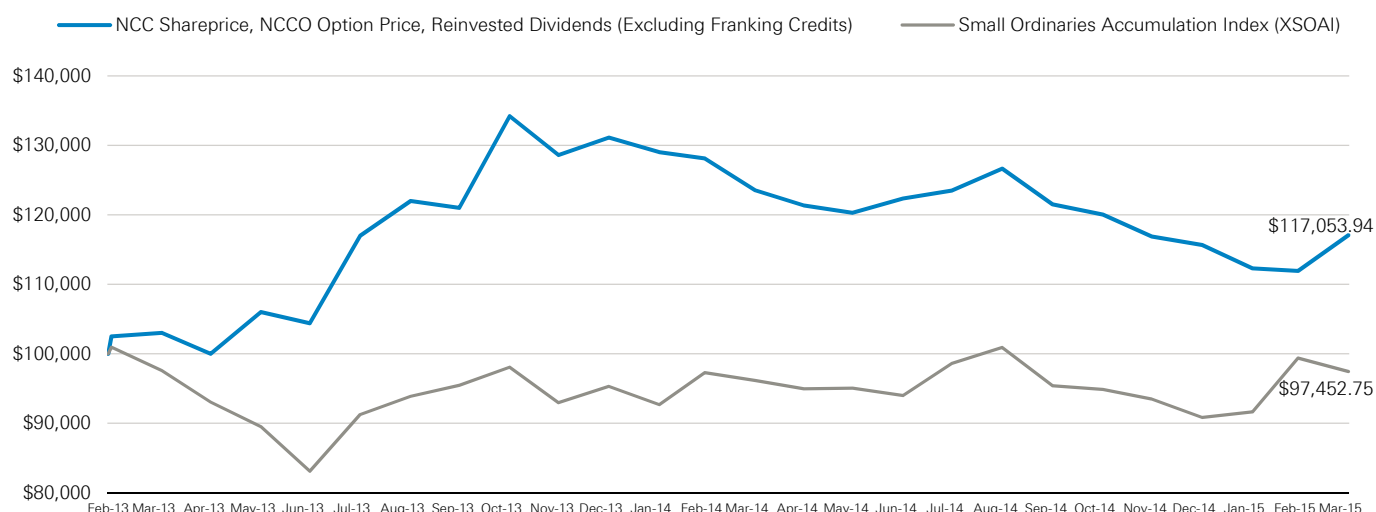


### Positive Stock Attribution Analysis (1<sup>st</sup> March 2013 to 31<sup>st</sup> March 2015)

Below is a chart which lists the top positive contributors to NCC total return since 1st March 2013. The purpose of the chart is to illustrate that the performance the investment team derive over time is not simply from one or two positions but from a variety of positions, even with a highly concentrated portfolio of investments that is often 0 -15 securities at any one time. We will disclose securities that the Company has a substantial holding in or when we have exited the name. All of the below may either of been a long or short position.

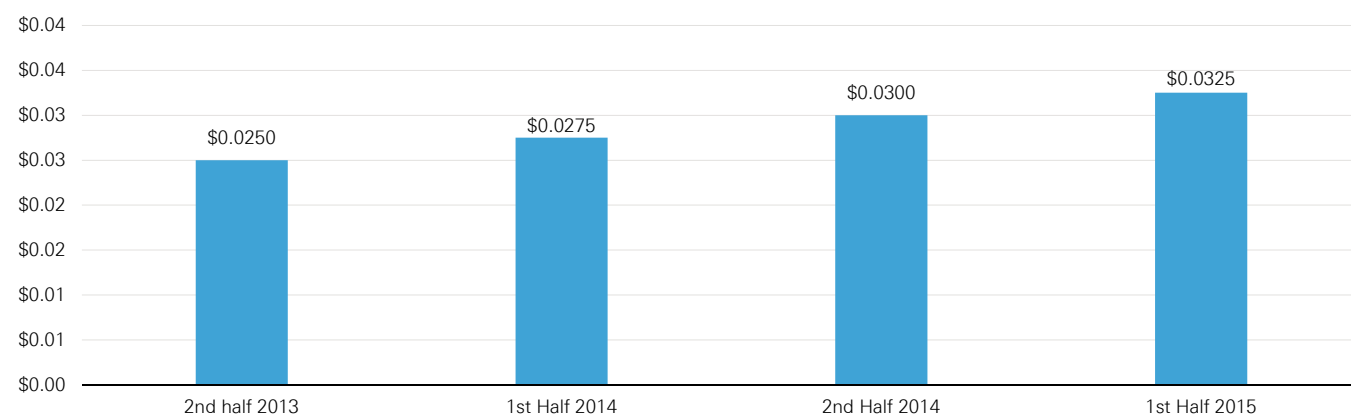
Investment	Contribution to Return (%NAV)	Investment	Contribution to Return (%NAV)
Calliden Group Limited	+13.02%	Village Roadshow	+5.73%
Capitol Health Limited	+10.13%	Investment A	+0.87%
Lindsay Australia	+7.96%	RHG Limited	+4.94%
Tamawood Limited	+6.04%	Gage Road Brewing	+4.34%
BSA Limited	+5.74%	AMA Group Limited	+2.71%

### Shareholder Return Analysis (IPO Investors)\*



\*Assumes an intrinsic value of \$0.02 cents per option at expiry (1st February 2015).

### Historical Fully Franked Dividends (Cents per Share)



## Portfolio Positioning as at 31<sup>st</sup> March 2015

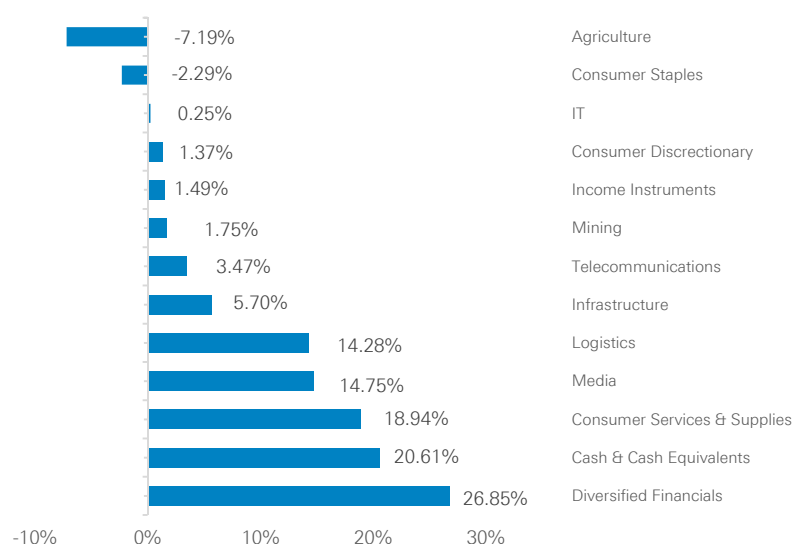
NCC closed out one position during the month of March resulting in the portfolio being comprised of 16 positions as at month end. These were 2 short equity holdings, 12 long equity holdings and 2 income/debt securities.

The top 5 positions within the Company represent approximately 63.75% of the net asset value. It should be noted that all of the long equity positions are profitable businesses with a majority having net cash balance sheets and dividend paying. The largest market capitalisation of any position is \$1.7 billion with the smallest having a market capitalisation of \$25 million.

Looking forward, the returns of the investment portfolio performance of NCC will depend significantly on the underlying performance of its key investments. The investment team remains very confident in the prospects of these businesses, especially the top 5 within the investment portfolio such as BSA, LAU and EGG, with all positions being added to in the month of March post detailed discussions with the management teams with regard to the 1HFY15 results and subsequent outlook.

As always, the investment team will continue to focus on the quality of investments and not quantity, especially in times of relatively high valuations levels for many businesses that have traditionally traded on much lower fundamentals.

## Industry Exposure



## Market Insight

The S&P/ASX-200 ended the month of March with a negative return of -0.63%. For Q1 2015 however, the index finished up ~9% which makes this the highest returning first quarter in 24 years.

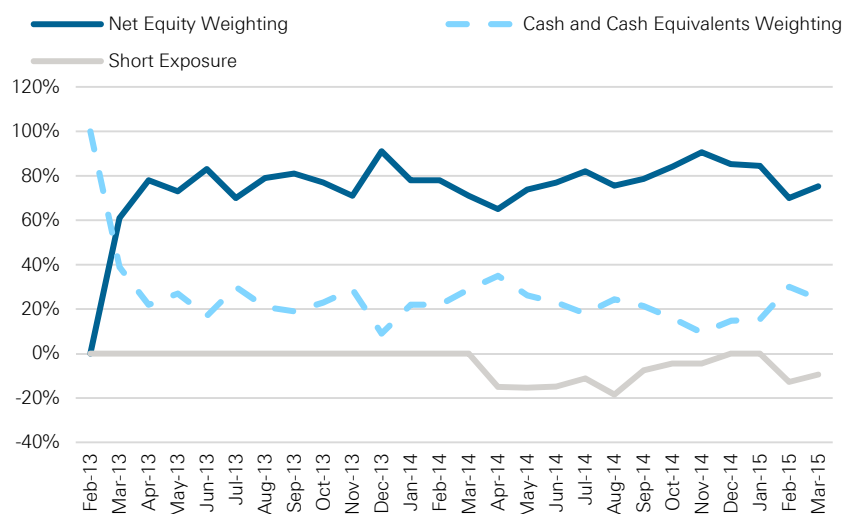
After such a strong run in equity market performance, investors are again faced with the dilemma of high absolute valuation levels against low relative valuation levels due to prevailing low bond yields. The quandary for investors is deciding whether or not there will be a ceiling to the positive effect of low interest rates. Interestingly, both globally and also in Australia investors have historically responded positively to falling interest rates, perhaps due to the fact that there have been no examples of a low interest rate environment leading to recession or stagflation (apart from Japan over the last 20 years).

Given the poor earnings performance of the Resources sector we believe it is an ideal time to focus on the valuations of Industrials Ex-Financials. The P/E of this sector is now approaching 18.5 times which although is well above the average level, is still below the previous bull market valuations levels of 2008 and 2000 which were 19.5 and 23.5 respectively. At such valuations levels, Naos believes a view should be taken with regard to the amount of risk (and marginal return) investors are taking for every extra dollar allocated to equities. The primary theme being spoken about by investors continues to centre on the low return of cash investments and the subsequent flow of money from cash securities into property and equities. On a risk adjusted basis some investors may find that a low cash return with no capital risk may be more attractive than a bank share on a 5% fully franked yield on peak cycle earnings with record low bad and doubtful debt provisions.

The chart below shows that the correlation between Annual Building Approvals and Housing Credit Growth was very high until late 2007/the onset of the GFC. Since then, and with lower interest rates driving building approvals, we have not seen the same subsequent effect in credit growth. Our assessment of the developing trend is that people's attitude to debt has changed, particularly as the nation's average age continues to rise and the baby boomers head into retirement.

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## Net Equity Exposure



## Portfolio Characteristics – Summary Data

Total Number of Equity Holdings (Long & Short)	14
Total Number of "Income" Instruments	2
Total Number of Holdings	16
Median Market Capitalisation	\$144m
Percentage of Positive Months	73%
Best Monthly Return	+9.19%
Worst Monthly Return	-4.84%

A summary of the statistical terms used in the table above can be found on the page following.

## Company Meetings

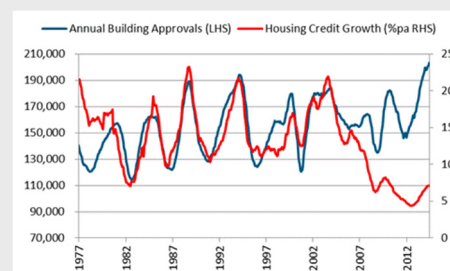
The NAOS investment philosophy is based around the belief that for an Emerging Company to succeed and generate strong returns for shareholders it must be led by a motivated, proven and experienced management team that is why the NAOS Investment Team has direct contact with many listed and unlisted Emerging Companies across a wide range of industries.

During the month of March the Investment Team had direct contact with over 65 unlisted and listed companies, a broad selection of those met with is provided as follows:

- Affinity Education (AFJ)
- Clarius (CND)
- 3P Learning (3PL)
- My Net Fone (MNF)
- BSA Limited (BSA)
- Praemium Limited (PPS)
- Rhipe Limited (RHP)
- Appen Limited (APX)
- Vita Group (VTG)
- Tasmanian Poppies (IPO)
- Objective Corporation (OCL)
- Lindsay Australia (LAU)

## Market Insight Cont.

We believe there has been a clear preference by individuals not to increase their personal debt levels regardless of the attractive cheap credit being offered. A significant impact of this change in preferences is that interest rate cuts by the RBA have not had the multiplier effect that they did a number of years ago. The flow on from this may be that more rate cuts are necessary.



## **CORPORATE DIRECTORY**

### **Directors**

David Rickards (Independent Chairman)  
Warwick Evans (Director)  
Sebastian Evans (Director)

### **Company Secretary**

Lawrence Adams  
Investment Team  
Sebastian Evans (Chief Investment Officer)  
Ben Rundle (Portfolio Manager)  
Jeffrey Kim (Portfolio Manager)  
Robert Miller (Portfolio Manager)

### **Business Development**

Anneke Senden

### **Share Registry**

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7/207 Kent Street  
Sydney NSW 2000  
Telephone: 1300 737 760  
Facsimile: 1300 653 459

### **Investment Manager**

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Level 4, Domain House  
139 Macquarie Street  
Sydney NSW 2000  
(AFSL: 273529)  
Telephone: (02) 8064 0568  
Facsimile: (02) 8215 0037

### **Auditor**

Deloitte Touche Tohmatsu  
Level 25, Grosvenor Place  
225 George Street  
Sydney NSW 2000

### **Registered Office**

Level 4, Domain House  
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Sydney NSW 2000  
Telephone: (02) 9947 2566  
Facsimile: (02) 8215 0037

### **ENQUIRIES**

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