

NAOS Absolute Opportunities Company (NAC)

NAOS

MONTHLY INVESTMENT REPORT AND NTA UPDATE

MAY 2015

COMPANY OVERVIEW

Investment Objective

The NAOS Absolute Opportunities Company (ASX: NAC) provides investors with exposure to domestic and international companies in a manner which has low correlation to broader equity market movements. The Company seeks to pay a minimum yield of 4.00% p.a., franked to the maximum extent possible. The Company seeks to generate income for investors through a concentrated long/short portfolio structure.

Investment Process

A unique 5 step investment process that places a strong emphasis on assessing company valuation, long term industry dynamics and management team capabilities; with particular focus on their track record of producing significant shareholder value over the medium to long term.

Investment Strategy

To actively manage a concentrated portfolio (approximately 0-30 positions) of high quality ASX and internationally listed companies across a wide range of industries which investors may have otherwise limited exposure to.

The Company has adopted a concentrated, absolute return, long/short strategy, placing primary focus on generating positive absolute returns and not relative outperformance in all market conditions.

Inception Date: 12th November 2014

Share Price at 31st May 2015: \$0.95

Benchmark: RBA Cash Rate + 250bps

**Shares on Issue (ASX: NAC):
21,500,000**

**Listed Options on Issue Exercisable
at \$1.00 Prior 30th November 2016
(ASX: NACO): 21,500,00**

**Dividend Yield: Targeted Minimum
4.00% p.a.**

**Total Directors Shareholding in NAC:
1,039,878 Ordinary Shares**

Net Tangible Asset Value Breakdown as at 31st May 2015

Pre Tax NTA:	\$1.08
Post Tax & Pre Unrealised Gains Tax:	\$1.07
After Tax NTA:	\$1.06

*The above NTA calculations do not account for any potential dilution from the 21,500,000 NACO options that remain on issue (expiry 30th November 2016) and which are exercisable at \$1.00

Investment Portfolio Performance to 31st May 2015

The NAC portfolio posted a record positive return of +4.87% for the month of May. This compared favourably to the benchmark (RBA Cash +250bps) return of 0.40%. The majority of the portfolio's long positions (both those listed in Australia and in International Developed Markets) recorded strong returns for the month.

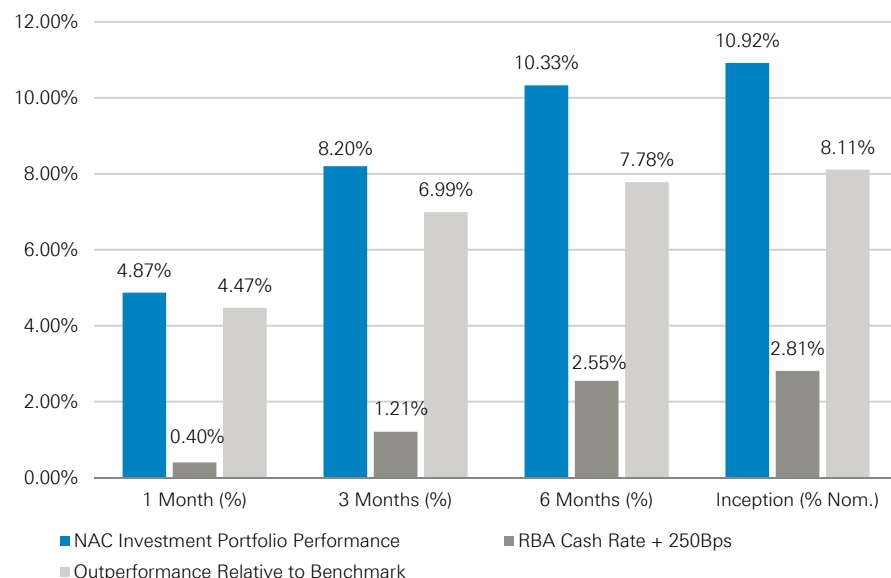
A notable contributor to performance for the period was Sirtex Medical (SRX). Our position in SRX was initiated following a significant sell-off in the stock mid-May which saw the share price fall ~55%. The sell-off occurred as a result of disappointing news flow in relation to the results of an initial clinical trial by the company. The degree of the sell-off, we believed, was overstated and left the company being valued at significantly less than what we thought was fair value; particularly in light of the company's net cash balance sheet position, the strength of the management team (regarded as one of the best within the Australian healthcare sector) and the potential for the company to release further positive clinical data evidence in relation to their research and treatment solutions. We initiated a position on this premise at this time and our thesis was rewarded, as by the month end close, following the release of further positive clinical data, the stock rallied +35% and we closed out our position resulting in meaningful gains for the portfolio.

Another positive contributor to portfolio performance for the month was our holding in Hella KGaA Hueck. We recently opened this as a long position in the portfolio and, following a period where the stock experienced some downward price pressure, it rallied strongly to close the month up by +7.1%

Another of our key holdings, James Hardie (JHX), also reported a stellar result during the month. Our thesis on JHX was centred on the pickup in US housing starts. Housing starts fell sharply as a result of the collapse of the credit driven housing boom in the US and the effect this had on consumer confidence. Following a significant rebase in prices, JHX has been able to maintain their revenue by taking market share and putting through price improvements. They have proven they can manage capital allocation through times of crisis and use it as an opportunity to position themselves for a recovery. As a result of the positive report to market and subsequent positive movement in share price, we took the opportunity to close out our position in JHX and redeploy capital into other US homebuilders who are also experiencing favourable market conditions, but trade at a much cheaper multiples.

	1 Month	3 Months	6 Months	Inception (Nom.)
NAC Investment Portfolio Performance*	+4.87%	+8.20%	+10.33%	+10.92%
Benchmark (RBA Cash Rate + 250bps)	+0.40%	+1.21%	+2.55%	+2.81%
Outperformance Relative to Benchmark	+4.47%	+6.99%	+7.78%	+8.11%

*Investment Portfolio Performance is post all operating expenses, before fees and taxes.

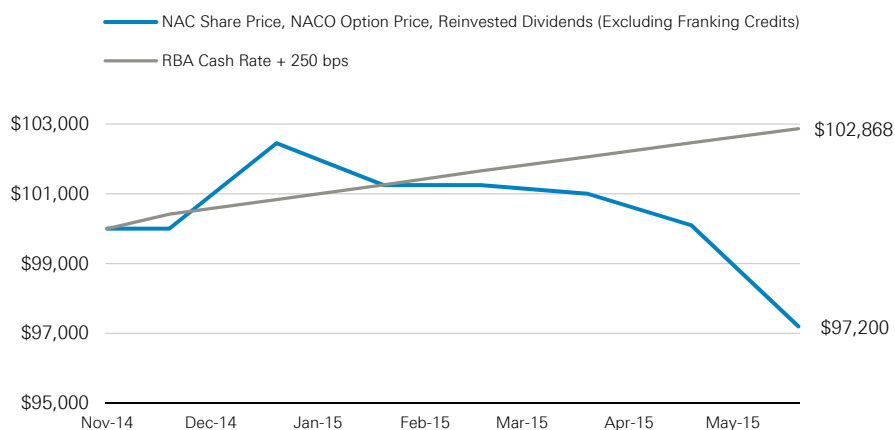


Positive Stock Attribution Analysis (12th November 2014 to 31st May 2015)

Below is a table which lists the top positive contributors to NAC total return since inception. The purpose of the table 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 0-30 securities at any one time. Positions in the table below may have been held either on the long or short side of the portfolio at any given point in time.

Investment	Contribution to Return (%NAV)	Investment	Contribution to Return (%NAV)
USD ETF	+5.08%	Reece Australia Limited	+1.11%
Sirtex Medical Limited	+2.25%	National Australia Bank Limited	+0.85%
Iselect Limited	+1.82%	Macquarie Group Limited	+0.74%
Amalgamated Holdings	+1.77%	Village Roadshow Limited	+0.64%

Shareholder Return Analysis (IPO Investors)



Market Insight

The old adage 'sell in May and go away' rang true for the Australian market, but not so globally. The ASX200 was -0.22%, the S&P500 in the US was +1% (+4% in AUD) and the Stoxx 600 in Europe was +1% (+2% in AUD). The main attraction in global markets for the month was in China which continued its bull run, up another +7.2%.

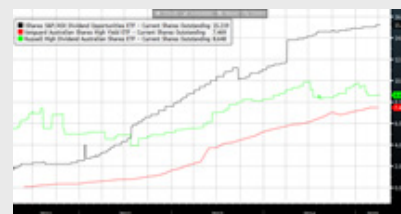
In Australia, the RBA cut rates by 25bps, however they removed their dovish tone and despite the cut, the AUD rallied against the Greenback. The situation was rectified later in the month with the RBA reinforcing their easing bias.

A key area of concern we are seeing in the equity markets at the moment is around the chase for yield. We recently came across a quote from legendary investor Seth Klarman who runs Baupost in the US. He noted that;

"When interest rates decline to single digits, many investors remain infatuated with the attainment of higher yields and sacrifice credit quality to achieve them in either the bond market or the equity market"

HOWEVER, this was not a *recent* quote from Mr Klarman. He said this in the 1980s. Back then, just as is happening now, there is a significant drive for yield from investors when making investment decisions. It didn't end well in the 1980's and we are very cautious that history may repeat itself in the current environment.

We have noticed a significant increase in the popularity of Dividend ETFs (Exchange Traded Funds). The chart below looks at the significant growth in shares outstanding for each ETF, which has been huge.



ETF's are passive investors, who invest in companies solely on the basis of headline dividend yields. When looking at ETF's as potential investments, investors need to ask themselves "what happens to the underlying stock when the dividend is cut and the ETF has to sell its position?" We saw a classic example of this with Metcash recently cutting their dividend and the stock subsequently falling c20% on the open. In the case of Metcash, according to Goldman Sachs research, roughly 7% of the entire company was owned by dividend ETF's.

Portfolio Characteristics – Summary Data (as at 31st May 2015)

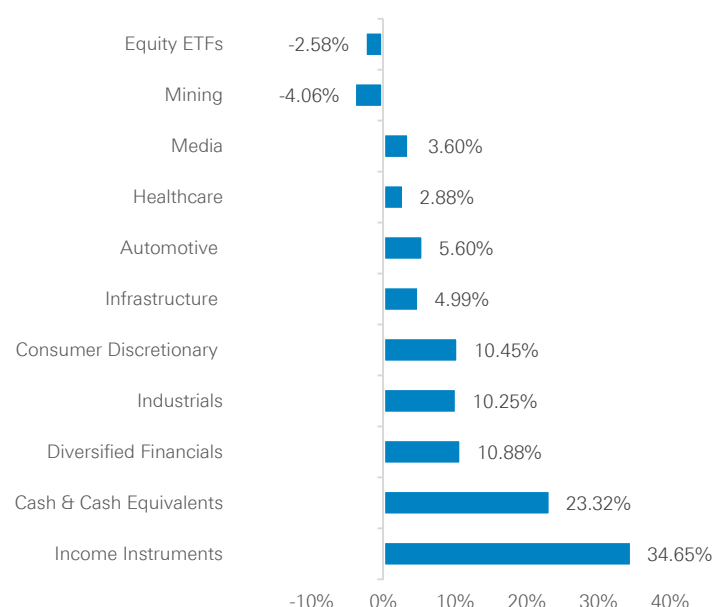
Total Number of Equity Holdings (Long & Short)	16
Total Number of "Income" Instruments*	9
Total Number of Holdings	25
Median Market Capitalisation	\$ 1.44 Billion
Percentage of Positive Months (NAC)	86%
Percentage of Positive Months (XAOAI)	57%
Standard Deviation of Returns (NAC)	+6.80%
Standard Deviation of Returns (XAOAI)	+10.24%
Correlation of Returns to XAOAI	-1.53%
Sortino Ratio	Not available*
Current Estimated Portfolio Beta	0.10

*Listed and unlisted bonds, convertible notes, preference shares and other income securities – both domestic and international. Calculation of the Sortino Ratio requires more than one month negative return.

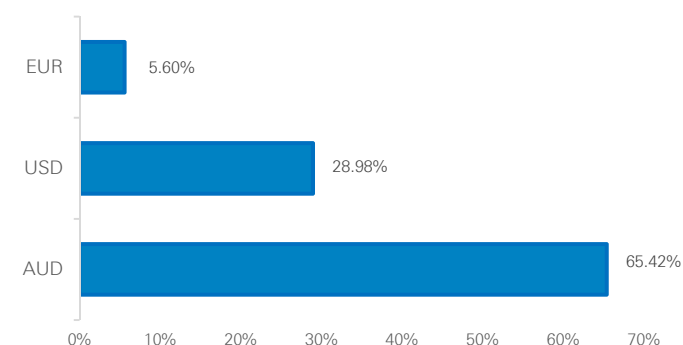
Portfolio Positioning as at 31st May 2015

We continue to position our portfolio cautiously given where market valuations sit compared with historical metrics. We continue to find attractive opportunities in geographies within Europe, where we feel the economy is recovering from a very low base and company valuations are attractive compared to elsewhere around the globe.

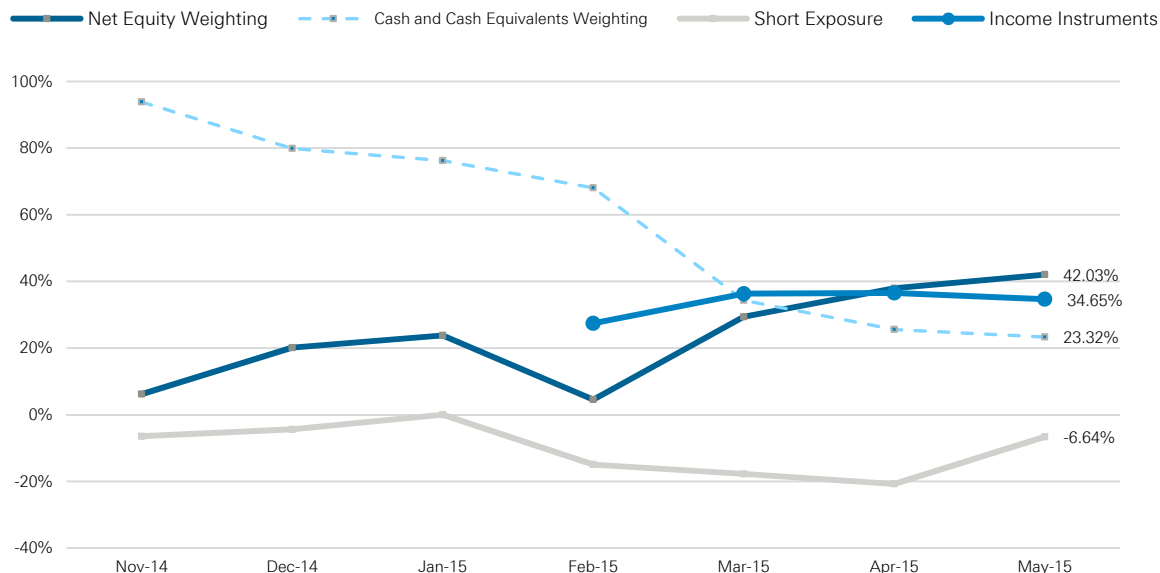
Industry Exposure (Equity & Income Instruments)



Currency Exposure



Net Equity Exposure



Company Meetings

The NAOS investment philosophy is based around the belief that for a 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 contact with many listed and unlisted companies across a wide range of industries and geographies. During the month of May, the NAOS Investment Team engaged with over 35 unlisted and listed companies, a selection of those met with is provided as follows.

- Technology One (TNE)
- Pulte Group (PHM US)
- Moleskin (MSK IM)
- DR Horton (DHI US)
- GBST (GBT)
- AerCap (AER US)
- Capitol Health (CAJ)
- Elders (ELD)
- James Hardie (JHX)
- Sirtex Medical Limited (SRX)
- Blackmores (BKL)
- Veda (VED)

Description of Statistical Terms/Glossary

Portfolio Weighted Average Market Capitalisation – The portfolio weight of each individual position multiplied by each companies respective market capitalisation.

Standard Deviation of Returns – A historical analysis of the volatility in monthly returns also known as historical volatility.

Correlation of Returns – A statistical measure of how two securities move in relation to each other. In this case the two securities are NAC and XAOAI. If the correlation is 1 then the two securities should have the same monthly returns and if the correlation is -1 and XAOAI had a return of -1.00% then NAC would be expected to have a return of +1.00%

Sortino Ratio – A modification of the Sharp ratio that differentiates harmful volatility from general volatility by taking into account the standard deviation of negative asset returns, called downside deviation. A large Sortino may potentially indicate that there is a low probability of a large capital loss.

Portfolio Beta – A measure of the volatility, or systematic risk of a portfolio or security. A beta of 1 indicates a portfolio/security's price will move with the market. A beta of 1 means that the security/portfolio will be less than volatile than the market.

XAOAI – All Ordinaries Accumulation Index (XAOAI)

Disclaimer:

This report has been prepared by NAOS Asset Management Ltd. Information retained in this report does not represent advice. In preparing this report we have not taken into account the investment objectives, financial situation or needs of any particular investor. Past performance is not a reliable indicator of future performance. Before making an investment decision investors must the offer documents and should seek their own financial product advice. Information in this report has been given in good faith. Returns are compounded for periods greater than 12 months. The Investment Manager of the Company is NAOS Asset Management Ltd (ABN 23 107 624 126, AFSL 273529). NAOS Address: Level 4 Domain House, 139 Macquarie Street Sydney NSW 2000. NAOS Telephone: 61 2 9947 2566

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Warwick Evans (Director)
Sebastian Evans (Director)

Company Secretary

Lawrence Adams

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