

# NAOS Emerging Opportunities Company (NCC)

NAOS

## MONTHLY INVESTMENT REPORT AND NTA UPDATE

MAY 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. 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 delivering shareholder value over the medium to long term.

#### Investment Strategy

To actively manage a concentrated portfolio (approximately 0-20 positions) of high quality emerging companies (typically ASX ex 100) across a wide range of industries, which investors may have had limited exposure to.

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**

**Share Price at 31<sup>st</sup> May 2015: \$1.035**

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

**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): 11,789,026**

**Total Directors Shareholding in NCC: 3,210,079 Ordinary Shares**

### Net Tangible Asset Value Breakdown as at 31<sup>st</sup> May 2015

<b>Pre Tax NTA:</b>	<b>\$1.13</b>
<b>Post Tax &amp; Pre Unrealised Gains Tax:</b>	<b>\$1.13</b>
<b>After Tax NTA:</b>	<b>\$1.11</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> May 2015

The investment portfolio posted a positive return of +2.37% for the month of May. The benchmark (Small Ordinaries Accumulation Index (XSOAI)) rose by +2.35% for the same period.

The majority of the portfolio's long positions produced strong returns for the month with Sirtex Medical (SRX) being a notable contributor to the portfolio's overall positive performance.

As many investors would be aware, NCC held a large position in SRX over 2 years ago. While NCC's exposure produced excellent returns for the period held, the Investment Team made the decision to close out their position just prior to the market release of initial clinical trial data on the basis of protection from potential downside. Subsequent to the release of the data, which disappointed, the SRX share price fell by over 55%. At this level we believed the market had meaningfully undervalued the business, particularly in light of the company's net cash balance sheet, the quality of its management team (who are considered 'best in class' in the Australian healthcare space) and in light of future potential upside from further clinical data to be released. On this basis, NCC once again acquired a significant interest in SRX and following our acquisition, in late May, SRX released favourable data in relation to the prognosis of patients who have used their SIRT product with a focus on the treatment of liver cancer. As a result of the information released the stock rallied by ~35% and, at this point, we sold down our interest in SRX and realised meaningful gains for the portfolio.

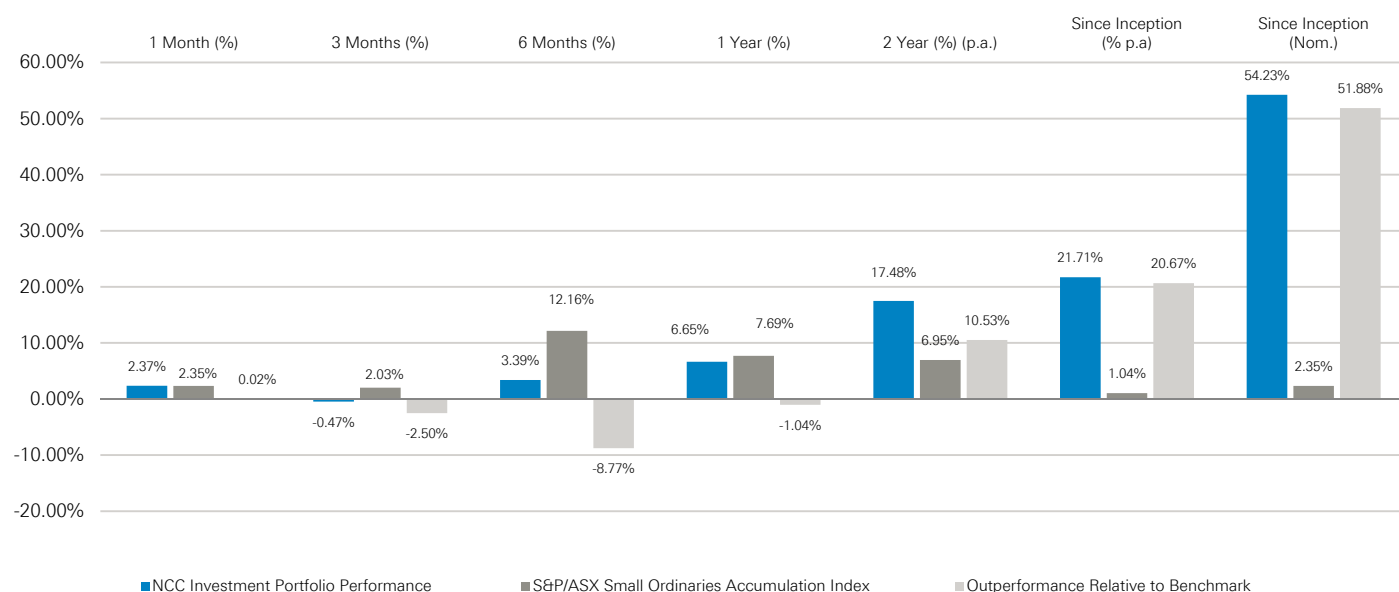
The SRX example highlights NCC's ability to be nimble in order to benefit from such opportunities as they arise and also the Company's ability to adopt positions that have the ability to make a meaningful impact on portfolio returns.

	1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	Inception (p.a.)	Inception (Nom.)
<b>NCC Investment Portfolio Performance*</b>	+2.37%	-0.47%	+3.39%	+6.65%	+17.48%	+21.71%	+54.23%
<b>S&amp;P/ASX Small Ordinaries Accumulation Index (XSOAI)</b>	+2.35%	+2.03%	+12.16%	+7.69%	+6.95%	+1.04%	+2.35%
<b>Outperformance Relative to Benchmark</b>	+0.02%	-2.50%	-8.77%	-1.04%	+10.53%	+20.67%	+51.88%

\*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.

## NAOS Emerging Opportunities Company (NCC)

### Monthly Investment Report and NTA Update | May 2015

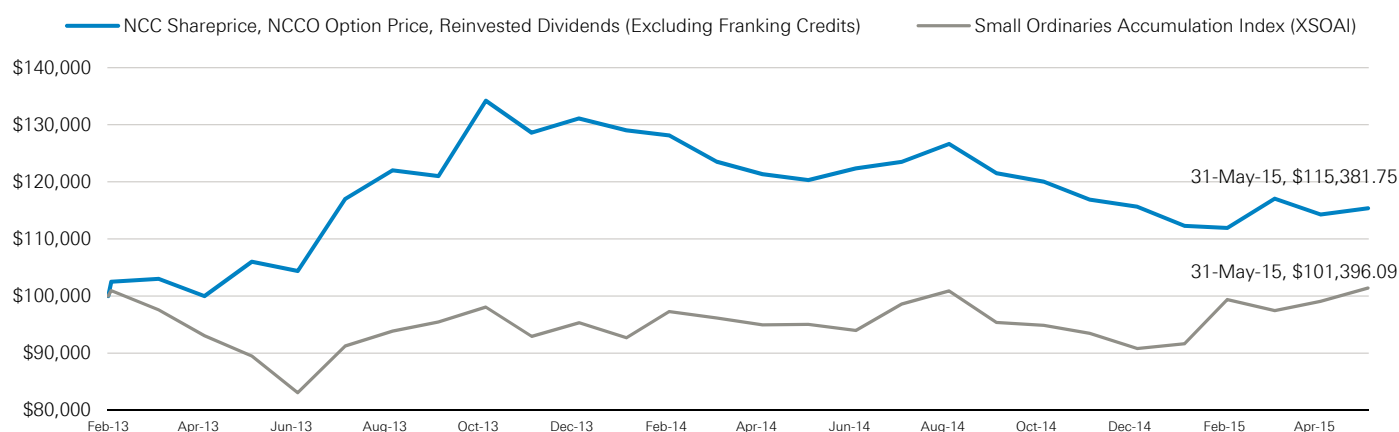


### Positive Stock Attribution Analysis (1<sup>st</sup> March 2013 to 31<sup>st</sup> May 2015)

The table below 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.

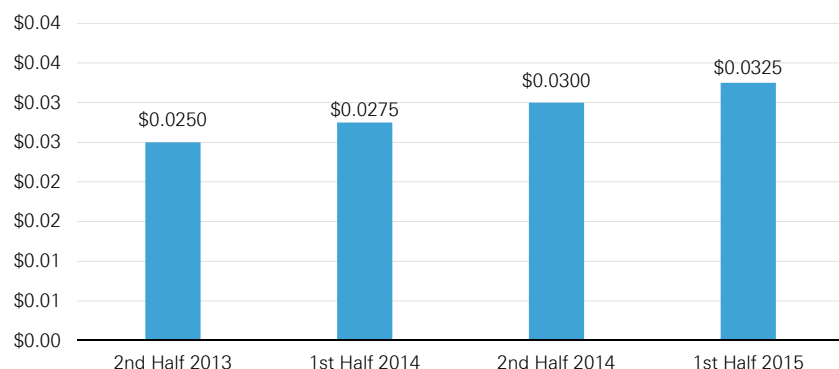
Investment	Contribution to Return (%NAV)	Investment	Contribution to Return (%NAV)
Calliden Group Limited	+10.76%	BSA Limited	+5.74%
Capitol Health Limited	+10.06%	Village Roadshow	+5.69%
Lindsay Australia	+8.44%	Investment A	+5.20%
Tamawood Limited	+6.01%	RHG Limited	+4.91%
Sirtex Medical Limited	+5.84%	Gage Road Brewing	+4.31%

### 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> May 2015

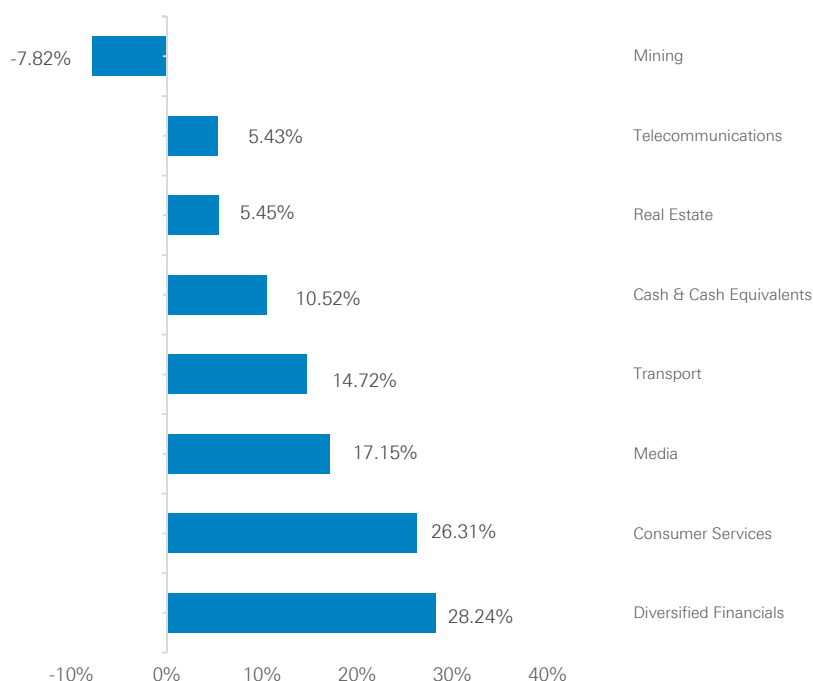
As at 31 May 2015, the portfolio was comprised of 13 holdings; 12 long and 1 short.

During the course of the month the portfolio holdings remained relatively unchanged, with the exception of a long position we entered into for Sirtex Medical (SRX) and the closing and replacement of a short position.

We closed a short on the basis of lack of clarity around the timing of the catalyst we had anticipated happening which, we believe, would have resulted in a fall in the company's share price. In its place we implemented a short position in a mining contractor that operates predominantly in the bulk commodities space.

The top 5 positions within the portfolio represent circa 60% of the NTA. The smallest company in the portfolio has a market capitalisation of ~\$20 million while the largest is capped at ~\$400 million.

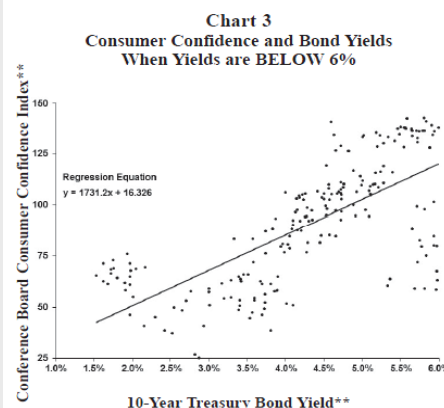
### Industry Exposure



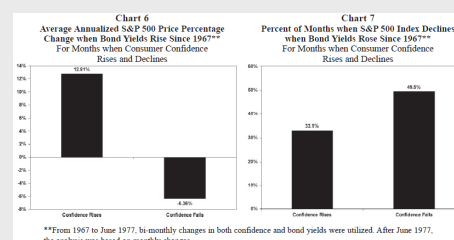
### Market Insight

Our market commentary for this month follows on from that of previous months; being centred on our views on global interest rates.

No doubt the ultimate call over the near term will be whether or not global interest rate rises will have a negative effect on economic growth and share price returns or vice versa. An excellent piece on this subject was recently distributed by renowned hedge fund manager James Paulson from Wells Capital Management based in the US. Paulson brings to light that, based on historical economic readings on US consumer confidence levels, when interest rates are below 6% (10-Year Treasury Bond Yields) consumer confidence tends to rise in a highly correlated manner. The key to Paulson's observation is that rising consumer confidence has a high correlation to that of equity market returns.



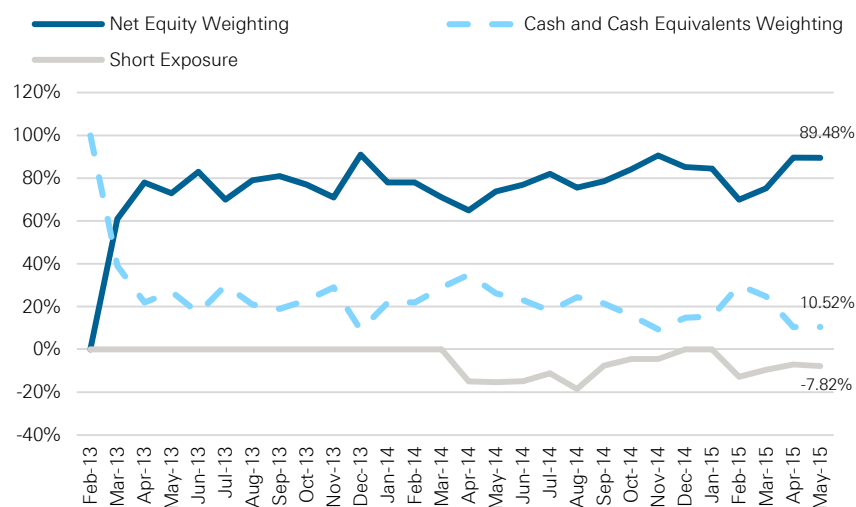
Paulson analysed over almost 50 years of data to extract and compile the two charts below. They simply look at market returns when bond yields rise and consumer confidence either falls or rises and then the subsequent movement within the equity market either positive or negative in this case.



If Paulson's conclusions hold true, many investors should be asking themselves why there has been such a strong retracement within the big four banks over the last 2 months.

Continued overleaf..

## Net Equity Exposure



## Portfolio Characteristics – Summary Data

Below are a number of historical portfolio risk measures. Our aim in providing these metrics is to demonstrate to investors how NCC is placed from a risk adjusted basis to meet its objective, being to outperform the benchmark over the long term and to preserve investors' capital. This month we have added the metric for downside deviation compared to that of the benchmark. This metric provides a basis upon which the volatility of negative returns can be assessed. A glossary of the terms used below and the method used for calculating them can be found on the last page of this report.

Total Number of Equity Holdings (Long & Short)	13
Total Number of "Income" Instruments	0
Total Number of Holdings	13
Portfolio Weighted Average Market Capitalisation	\$196 Million
Percentage of Positive Months (NCC)	71%
Percentage of Positive Months (XSOAI)	52%
Standard Deviation of Returns (NCC)	+11.11%
Standard Deviation of Returns (XSOAI)	+14.01%
Correlation of Returns to XSOAI	+48.27%
Sortino Ratio	+3.63
Current Estimated Portfolio Beta	0.10

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

## Market Insight Cont.

The chart below looks at the correlation in movement between the Australian banks versus the price movement in German Bunds (Bonds). We can see that as bond prices fall their subsequent yield will rise and therefore make the yield on a bank dividend less attractive. Although the analysis above may well prove correct over the next 1-3 years, particularly as the US look to raise rates on the back of an ever improving economic backdrop, we believe the key variable in securities pricing in the near term will be the significant amount of liquidity, or so called free money, that has been pushed into equity markets around the world and that is simply playing an interest rate arbitrage game. There should be no doubt that this liquidity will be withdrawn at some stage and equity market movements in yield driven investments may fall regardless of the economic backdrop as the risk free rate continues to rise.



### 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 May the Investment Team had direct contact with over 35 unlisted and listed companies, a broad selection of those met with is provided as follows:

- |                        |                                   |                      |
|------------------------|-----------------------------------|----------------------|
| • Citadel Group (CGL)  | • OCL Group (OCL)                 | • AMA Group (AMA)    |
| • BSA Limited (BSA)    | • Sirtex Medical (SRX)            | • Nomad (NOD)        |
| • Eureka Group (EGH)   | • PMP Limited (PMP)               | • Pure Profile (IPO) |
| • Shriri Limited (IPO) | • Armidale Investment Group (AIK) | • Elders (ELD)       |

### 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 NCC and XSOAI. If the correlation is 1 then the two securities should have the same monthly returns and if the correlation is -1 and XSOAI had a return of -1.00% then NCC 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.

**XSOAI** – Small Ordinaries Accumulation Index (XSOAI)

#### 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

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

##### Investment Manager

NAOS Asset Management Limited  
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  
139 Macquarie Street  
Sydney NSW 2000  
Telephone: (02) 9947 2566  
Facsimile: (02) 8215 0037

##### ENQUIRIES

Anneke Senden  
Telephone: (02) 9947 2567  
Email: [asenden@naos.com.au](mailto:asenden@naos.com.au)  
[www.naos.com.au](http://www.naos.com.au)