

# NAOS Absolute Opportunities Company (NAC)

NAOS

## MONTHLY INVESTMENT REPORT AND NTA UPDATE

AUGUST 2015

### KEY CHARACTERISTICS

#### 1. Global, Multi Asset Class Exposure

Our ability to invest in a range of equity, fixed income, currency and commodity securities both in Australia and internationally provides us with the flexibility to capitalise on performance generating situations that would otherwise not be available through a traditional share portfolio. Our flexible mandate focus' on taking advantage of fluctuations and mis-pricing situations in investment markets both domestically and offshore.

#### 2. Positive Absolute Return Focus

Our primary focus is the preservation of shareholders capital and the generation of meaningful absolute returns. NAC offers investors the opportunity to derive a targeted minimum dividend of 4% p.a., which will be franked to the maximum extent possible.

#### 3. Focus on Meaningful Long Term Performance

When assessing investment opportunities we look for those ideas that offer meaningful, long term value accretion to shareholders. We place primary consideration on quality over quantity resulting in a concentrated portfolio of 'Best Ideas' (typically 0-30 holdings). When assessing our equity investments we adopt a value driven approach, further supporting our objective of long term gain.

#### 4. Ability to Hold +100% in Cash

We believe cash offers the 'best hedge' during times of crisis. We also believe holding cash allows us greater flexibility to take advantage of security mispricing opportunities as and when they arise.

#### 5. Demonstrating a Significant Alignment of Interests with Shareholders

NAOS employees/directors own a significant amount of shares and options in NAC. Our performance is also closely tied to the performance of the investment portfolio through the application of a Performance Based Fee.

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

|   |               |
|---|---------------|
| <b>Pre Tax NTA:</b>                             | <b>\$1.06</b> |
| <b>Post Tax &amp; Pre Unrealised Gains Tax:</b> | <b>\$1.04</b> |
| <b>After Tax NTA:</b>                           | <b>\$1.04</b> |

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

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

The NAC investment portfolio returned -1.35% for the month of August. The portfolio's exposure to US dollars went some way to support portfolio performance over the month, as did our holdings in Reece, Sirtex Medical and Moleskine. Unfortunately however, negative contributors outweighed the positive, mostly as a result of investors 'risk off' sentiment rather any stock specific issues/concerns and as such the portfolio was unable to post a positive return for the period.

Taking a look at the monthly performance of global markets, the Dow was down -6.6%, the S&P 500 -6.3%, the Stoxx 600 index -8.5%, the MSCI world -7.0%, China -12.5% and the ASX200 -8.6%. Putting the performance returns of the ASX200 into perspective, it has not suffered such a significant decline since October 2008, the height of the GFC.

Relative to the performance of global equity markets, we were pleased with how NAC's investment portfolio performed. We remain confident that the positioning of the portfolio is appropriate in the context of the current investment environment and we remain positive that the portfolio is in a position to make positive gains when the market rises as well as preserving capital when/if the market falls. We certainly remain confident that over the long term the investment objectives for the Company will be met.

The Australian contingent of the portfolio reported well during August's Reporting Season. Of key note were Amalgamated Holdings & Reece. Further information on key themes relating to Reporting Season can be read in this month's Market Insight.

|  | 1 Month | 3 Months | 6 Months | Inception (Nom.) |
|--|---------|----------|----------|------------------|
| <b>NAC Investment Portfolio Performance*</b> | -1.35%  | -2.58%   | +5.42%   | +8.06%           |
| <b>Benchmark (RBA Cash Rate + 250bps)</b>    | +0.38%  | +1.18%   | +2.41%   | +4.02%           |
| <b>Relative Performance</b>                  | -1.73%  | -3.76%   | +3.01%   | +4.04%           |

|  |        |        |        |         |
|--|--------|--------|--------|---------|
| <b>S&amp;P/ASX All Ordinaries Accumulation Index (XAOAI)</b> | -7.30% | -8.59% | -9.44% | -0.92%  |
| <b>MSCI ACWI AC (Div-Reinvested, AUD terms)</b>              | -4.13% | -1.37% | +2.24% | +17.68% |

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

\* Inception 12/11/2014

## Positive Stock Attribution Analysis (12<sup>th</sup> November 2014 to 31<sup>st</sup> August 2015)

Below is a table which lists the top positive contributors to NAC's 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) |
|------------------------------|-------------------------------|---------------------------------|-------------------------------|
| US Dollars                   | +5.92%                        | Reece Australia Limited         | +1.00%                        |
| Sirtex Medical Limited       | +2.16%                        | National Australia Bank Limited | +0.83%                        |
| Iselect Limited              | +1.41%                        | Moleskine SpA                   | +0.72%                        |
| Amalgamated Holdings Limited | +1.37%                        | Village Roadshow Limited        | +0.62%                        |

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

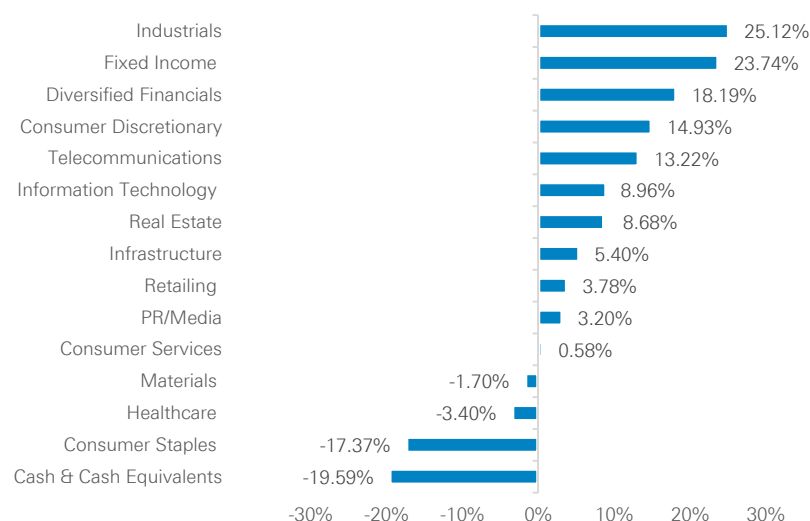
As at 31<sup>st</sup> August the portfolio held a total of 29 holdings comprising 22 equity positions (18 long and 4 short) and 7 income instruments.

The portfolio was geographically concentrated in Australia however we also maintained an exposure to the US (15.29%) and Europe (5.69%).

Heightened volatility and large sell offs in markets have the ability to create a lot of potential buying opportunities. During August we took advantage of some of these, increasing the portfolio's net equity exposure to ~79% over the course of the month. The new holdings in the portfolio were undertaken to complement our core holdings, which did not undergo any wholesale changes during the month. With the addition of the new exposures we are confident that the portfolio is both in a position to profit from a relief rally, should one occur, as well as be protected from any further fall in equity markets should it occur.

I mentioned last month that we had reduced our long USD, short AUD position. With hindsight we were a little early with this trade however, despite this, we maintained sufficient exposure levels to still result in a positive contribution to total portfolio return for the period. In Europe, we sold our position in Hella for a small profit due to our concern that a large proportion of the Company's profits were derived from products sold into the Chinese car market, which has been under pressure of late. We continue to monitor the stock and may re-enter the position at a lower valuation.

## Industry Exposure



## Market Insight

Global markets participated in an indiscriminate sell-off during the month that was mainly driven by China, who joined the currency devaluation race. At the beginning of the month, the Chinese adjusted their currency peg against the USD, thereby devaluing the RMB in an attempt to stem the flight of capital from the Country. The market saw this as sign of China slowing which was then compounded by weak economic data and then a failed attempt at market intervention. Global contagion then spread to markets such as the US, Europe and Australia.

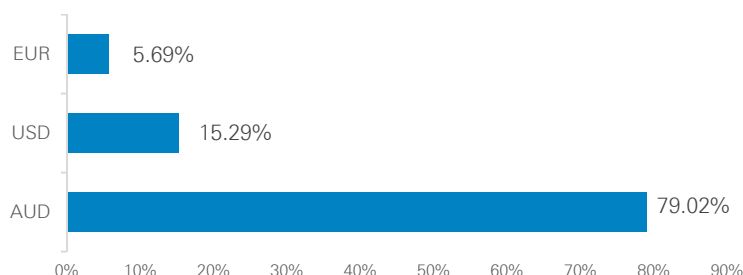
Negative equity market performance in Australia was compounded by a reporting season that was quite lacklustre by our standards. According to a broker research report, 62% of companies saw 2016 EPS estimates cut and top-line estimates were cut for most large capitalisation stocks as well as margin expectations being cut across the ASX300.

Looking at the reporting season from an industry perspective, suppliers to the mining sector continued to face tough conditions and, despite already being out of favour with the market, their share prices were decimated as a result of poor earnings. Healthcare was also a sector that missed analyst forecasts. Those that outperformed were the ones that investors were already looking bearishly at however who proved the market wrong. Some examples included Oz Forex, Ainsworth gaming and Sims Metals.

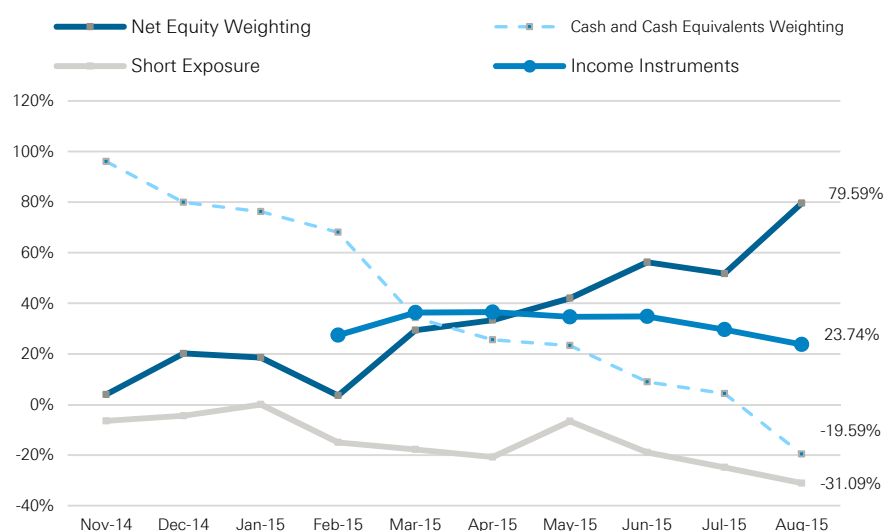
One of the key themes coming out of Reporting Season was the need for some companies to reinvest back into their businesses in order to maintain the growth rates we have seen of late. Forecast capex has also been lifted by at least 5% for all sectors except Resources and Financials. Companies also reported that payout ratios were also lifted to maintain dividends despite falling earnings estimates and therefore gearing is rising. Net debt to EBITDA ratios are now 10% higher for most sectors post reporting season.

One of the more positive signs coming out of reporting season was the performance of Consumer companies. Companies in this sector were no doubt helped in part by the budget giving tax breaks to small businesses, encouraging them to spend more. Both consumer staples and consumer discretionary stocks saw the highest levels of upgrades across the market.

### 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 August, the NAOS Investment Team engaged with over 60 unlisted and listed companies, a selection of those met with is provided as follows.

- Ozforex Group Limited (OFX)
- Domino's Pizza Enterprises (DMP)
- Capitol Health Group (CAJ)
- Sirtex Medical Limited (SRX)
- James Hardie Industries (JHX)
- REA Group (REA)
- SMS Management & Technology (SMX)
- Ardent Leisure Group (AAD)
- Amalgamated Holdings Limited (AHD)
- Breville Group Limited (BRG)
- Covermore Group Limited (CVO)
- UXC Limited (UXC)

### Market Insight Cont....

Looking to where our offshore exposures are held, starting with the US. We view the US as one of the better placed economies globally at present. The manufacturing sector has been weak primarily because of a contraction in the US energy industry, but outside of that, we think the US economy appears quite healthy. Jobs are being created at a pace which is twice as fast as growth in the labour supply, causing the unemployment rate to decline about 1% a year. Housing activity has strengthened significantly this year, auto sales are almost at an all-time record high and the US services sector ISM recently spiked to one of its highest levels in 10 years above 60. Most of the financial press in the US has been centred on a rise in the Fed's cash rate. In our view a 25 basis point rise in rates in the US will not slow the economic recovery there. We believe that the anticipation of these decisions, which have been well flagged, can often be worse than the actual event.

In Europe, we continue to find opportunities at valuations that are lower than global peers and we have also seen a huge amount of economic stimulus within the region. While our European exposure was slightly reduced during the period, we do not expect that to stay the case for long. We have done a good deal of research on a few stocks and when the prices are right we expect to be buying them.

In addition to the above, the team also participated in teleconferences with the management of the following international organisations:

- J2 Global (JCOM.US)
- Aercap Holdings (AC.FP)
- Comvita Limited (COM.NZ)
- Rolls Royce (RR.LN)

### Portfolio Characteristics – Summary Data (as at 31<sup>st</sup> August 2015)

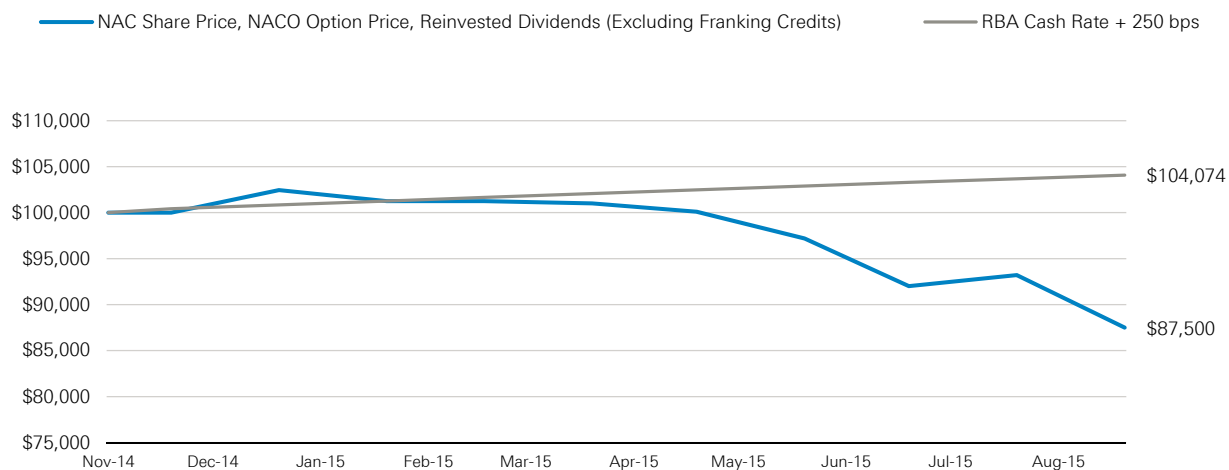
|  |        |
|--|--------|
| Total Number of Equity Holdings (Long & Short) | 22     |
| Total Number of "Income" Instruments*          | 7      |
| Total Number of Holdings                       | 29     |
| Median Market Capitalisation                   | \$850m |
| Percentage of Positive Months (NAC)            | 78%    |
| Percentage of Positive Months (XAOAI)          | 50%    |
| Standard Deviation of Returns (NAC)            | 6.90%  |
| Standard Deviation of Returns (XAOAI)          | 0.21%  |
| Correlation of Returns to XAOAI                | 22.39% |
| Sortino Ratio                                  | 50.43  |
| Downside Deviation                             | 0.20%  |
| Downside Deviation (XAOAI)                     | 6.13%  |
| Current Estimated Portfolio Beta               | 0.416  |

\*Listed and unlisted bonds, convertible notes, preference shares and other income securities – both domestic and international.

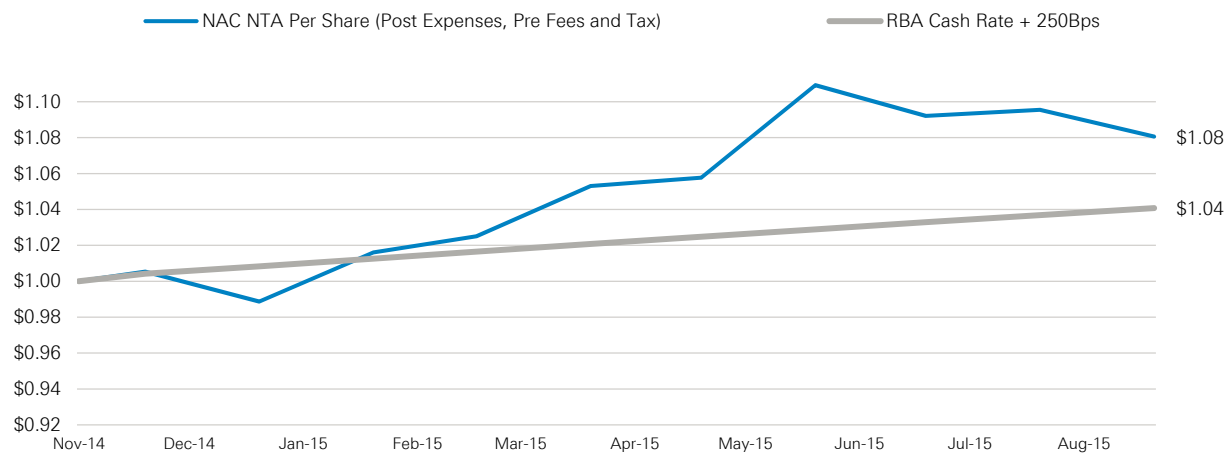
### Capital Management - Summary Data as at 31<sup>st</sup> August 2015

|                                      |            |
|--------------------------------------|------------|
| Share Price                          | \$0.86     |
| Discount to NTA (undiluted, pre tax) | 23.26%     |
| Fully Franked Dividend Yield         | 4.65%      |
| Shares on Issues                     | 21,500,000 |
| Options on Issue                     | 21,500,000 |
| Directors Shareholding               | 1,039,878  |

### Shareholder Return Analysis (IPO Investors)



**NTA Per Share (Post Expenses, Pre Fees and Tax) vs RBA Cash Rate +250Bps**



## 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.

**Downside Deviation** - A measure of downside risk that focuses on returns that fall below a minimum threshold or minimum acceptable return (MAR). For our calculations, we use returns negative to zero for the calculation of portfolio downside deviation.

**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

### CORPORATE DIRECTORY

#### Directors

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

#### Company Secretary

Lawrence Adams

#### Investment Team

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

#### Business Development

Anneke Senden

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