

# NAOS Absolute Opportunities Company (NAC)

NAOS

## MONTHLY INVESTMENT REPORT AND NTA UPDATE

October 2016

### KEY CHARACTERISTICS

**1. Domestic & Global Long/Short Exposure with a Long Term Value Focus**  
NAC invests in equities listed domestically and globally in a concentrated long short structure. NAC has the advantage of being able to invest not only in undervalued companies but also to short sell companies that the investment team believe are overvalued on a long term investment horizon.

**2. Positive Absolute Return Focus**  
The primary focus of the Company's investment strategy is the preservation of shareholder's capital and the generation of meaningful absolute returns with a lower downside volatility than traditional equity focused managed funds. 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**  
Investment opportunities are assessed based on their potential to generate meaningful long term performance. Of primary consideration is quality rather than quantity, resulting in a concentrated portfolio of 'Best Ideas' (typically 0-30 holdings).

**4. Ability to Hold +100% in Cash**  
It has been proven that holding cash offers the 'best hedge' during times of crisis. Holding cash also provides flexibility and nimbleness to take advantage of security mispricing opportunities as and when they arise.

**5. Significant Alignment of Interests with Shareholders**  
NAOS employees/directors own a significant amount of shares and options in NAC. Staff are remunerated on the basis of the performance of the firm's investment vehicles through the application of a Performance Based Fee.

### Net Tangible Asset Value Breakdown as at 31<sup>st</sup> October 2016

Pre Tax NTA:	\$1.24
Post Tax & Pre Unrealised Gains NTA:	\$1.24
Post Tax NTA:	\$1.19
Pre Tax NTA (Full Exercise of NACO):	\$1.20
Share Price	\$1.15

### Investment Portfolio Performance to 31<sup>st</sup> October 2016

The NAOS Absolute Opportunities portfolio produced a return of -0.22% for the month of October which brings the nominal return to +60.55% after almost 2 full years of operation.

MNF Group (ASX: MNF) held their AGM during the month and as a result of the market reacting favourably to the business update provided, MNF was the top contributor to the portfolios monthly performance. The key takeaway from the update is that MNF are forecasting 25% in EBITDA growth in FY17, which is purely organic and doesn't allow for any further upside from recent system/network upgrades, new business wins, or possible future acquisitions. Even more impressively, it also includes a significant increase in the expense base, specifically in software development, which is fully expensed and not capitalised.

Smartgroup (ASX: SIQ) was one of the worst performers for the month as two brokers published research with a 'Sell' recommendation on the stock. The research focussed on many key factors including valuation, growth potential, and customer retention risk. Specifically, on the point of valuation, most of the analysis referred to the price to earnings ratio (P/E) of SIQ compared to other listed peers. While P/E ratios do carry relevance to us when assessing valuations, we prefer to focus on return on invested capital (ROIC) as an indicator of management's ability to create value. Prioritising earnings accretion over ROIC results in investors following the earnings upgrades rather than looking at the asset they bought, the returns on the asset and whether they paid the right price. SIQ has a very impressive track record of return on invested capital and we do not see this changing in the short to medium term. We feel the stock now represents compelling value and as such we added to our position during the period.

	1 Month	3 Month	6 Month	1 Year	Inception (p.a.)	Inception (Nom.)
NAC Investment Portfolio Performance*	-0.22%	+8.80%	+17.79%	+40.93%	+27.19%	+60.55%
Benchmark (RBA Cash Rate + 250bps)	+0.36%	+1.09%	+2.27%	+4.73%	+4.86%	+9.80%
Relative Performance	-0.58%	+7.71%	+15.52%	+36.20%	+22.33%	+50.75%
S&P/ASX All Ordinaries Accumulation Index (XAOAI)	-2.18%	-3.09%	+3.77%	+6.63%	+3.86%	+7.74%
MSCI ACWI (Net, Dividends Reinvested, AUD Terms)	-1.23%	-1.02%	+2.93%	-3.94%	+8.17%	+16.71%

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

### Positive Stock Attribution Analysis

(Attribution is what has contributed to NAC's performance since Inception of 12<sup>th</sup> November 2014)

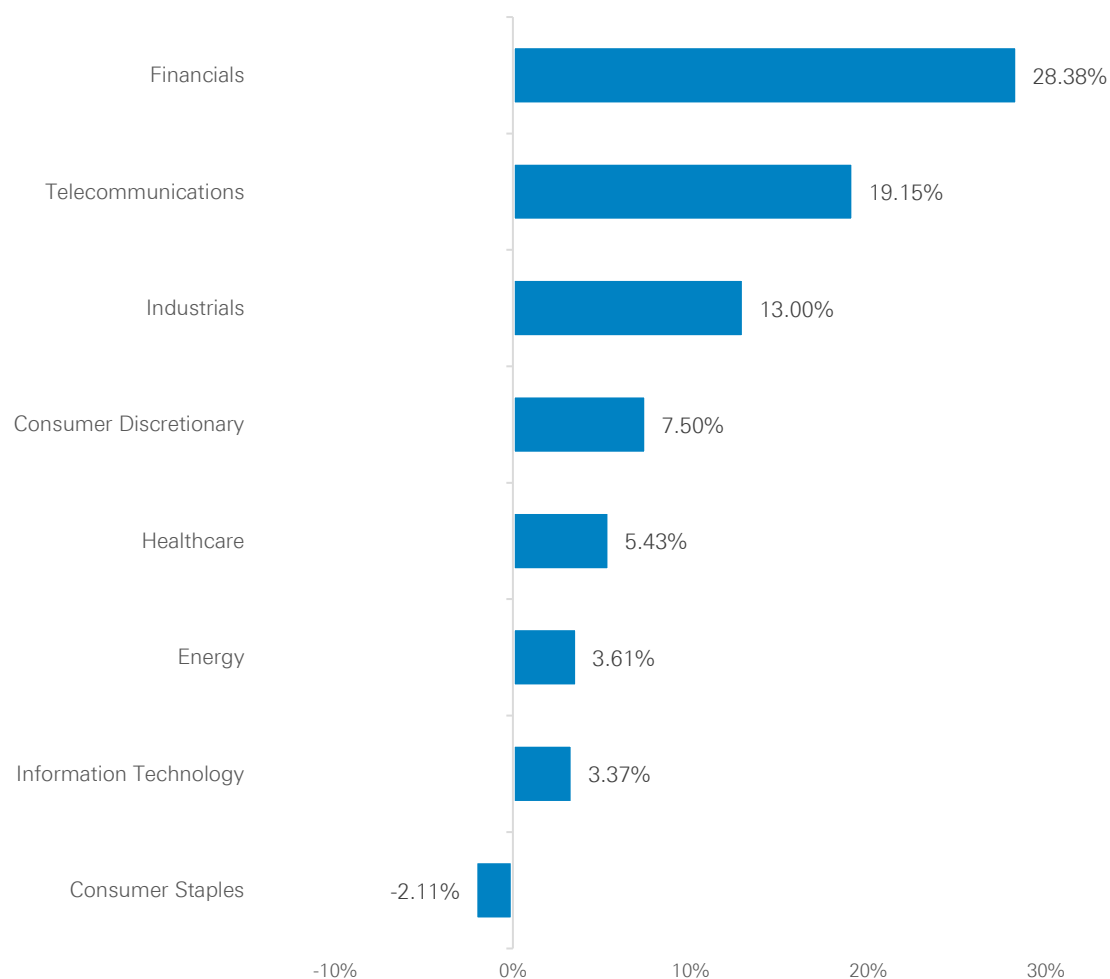
Below is a table listing the top positive contributors to NAC's total return since inception. The purpose of the table is to illustrate that the performance the investment team derive over time is not simply from one or two positions, but from a variety of positions, even with a concentrated portfolio of investments that is generally limited to 0-40 securities at any one time. Positions in the table below may have been held either as a long position or short position at any given point in time.

Investment	Contribution to Return (%NAV)	Investment	Contribution to Return (%NAV)
US Dollar	+9.88%	1-Page Limited	+3.94%
MNF Group	+6.17%	Sirtex medical	+3.92%
Event Hospitality	+4.98%	Smartgroup	+3.89%
BSA Ltd	+4.81%	Bellamy's Australia	+3.29%

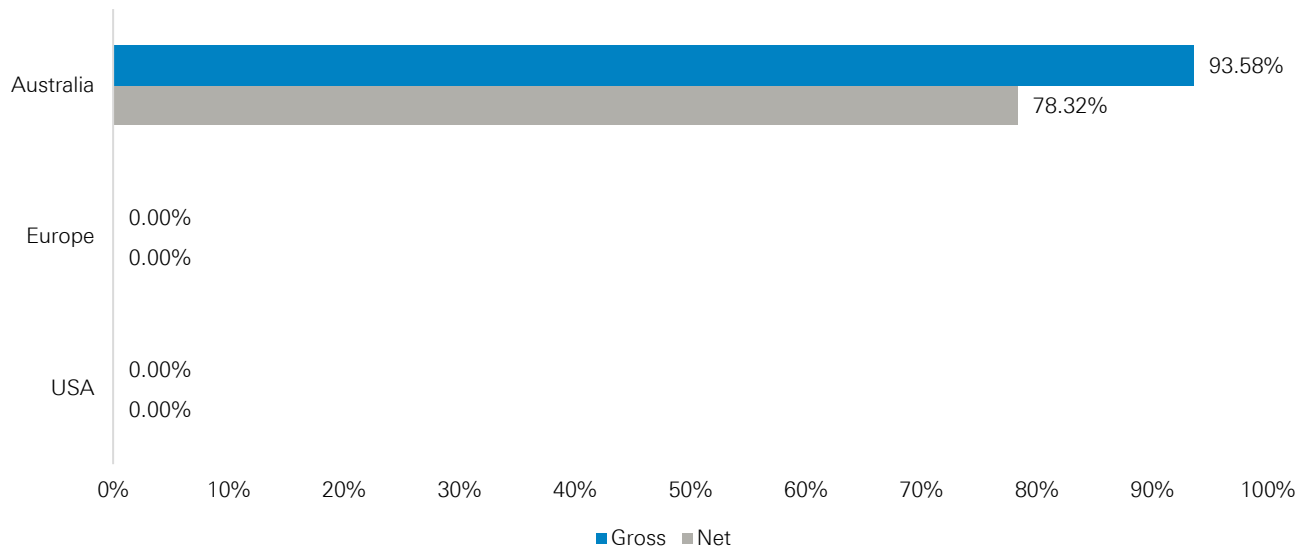
### Portfolio Analysis as at 31<sup>st</sup> October 2016

As at 31<sup>st</sup> October the portfolio comprised of 17 holdings, including 14 long positions and 3 short positions.

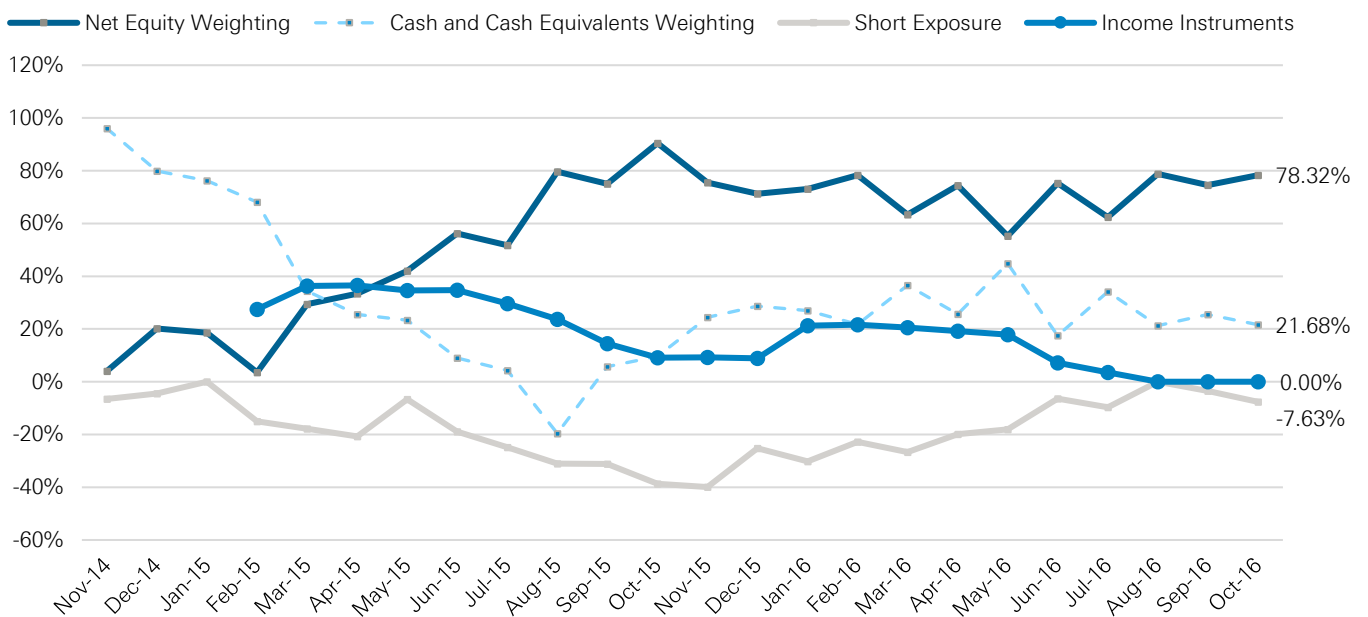
#### Net Industry Exposure



Geographical Equity 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. A selection of the unlisted and listed companies the team had contact with during the month of October were as follows:

- MNF Group (MNF AU)
- Sirtex Medical (SRX AU)
- Karoon Gas (KAR AU)
- Enero Group (EGG AU)
- Bega Cheese (BGA AU)
- PSC Insurance (PSI AU)
- Royal Wolf (RWH AU)
- APA Group (APA AU)
- QMS Media (QMS AU)
- Boral (BLD AU)

## Portfolio Characteristics – Summary Data as at 31<sup>st</sup> October 2016

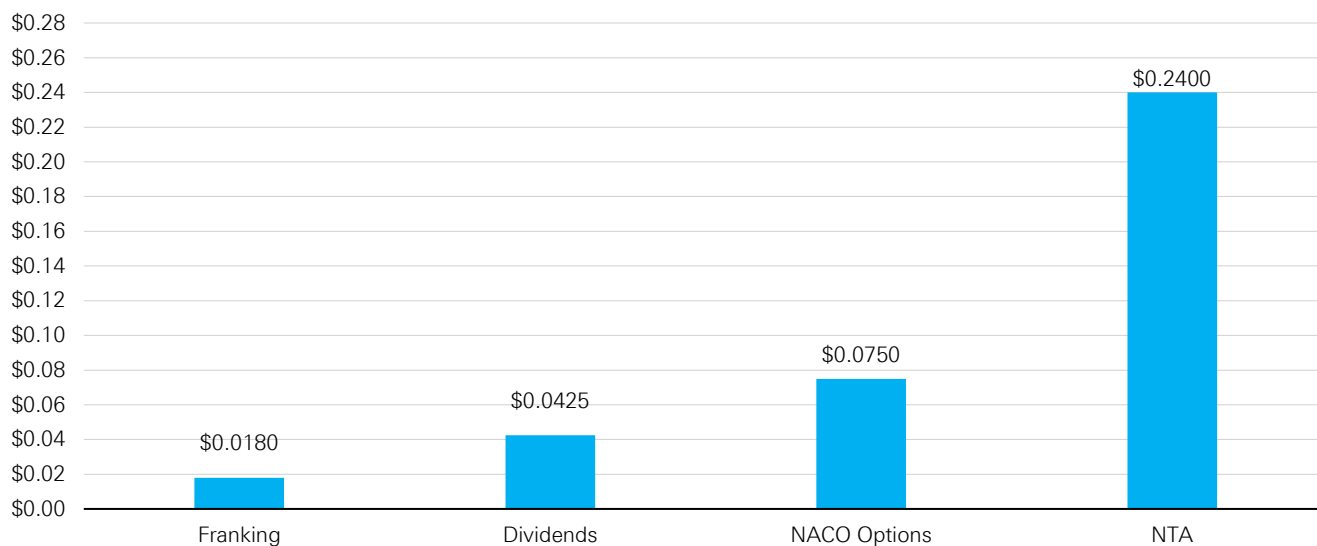
Total Number of Equity Holdings (Long & Short)	17
Total Number of Income/Debt Instruments*	0
Total Number of Holdings	17
Portfolio Weighted Market Capitalisation (AUD)	\$733.5m
Percentage of Positive Months (NAC)	71%
Percentage of Positive Months (XAOAI)	50%
Standard Deviation of Returns (NAC)	9.46%
Standard Deviation of Returns (XAOAI)	12.81%
Correlation of Returns to XAOAI	0.55
Sortino Ratio	11.59
Downside Deviation (NAC)	2.35%
Downside Deviation (XAOAI)	7.22%
Current Estimated Portfolio Beta	0.1284

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

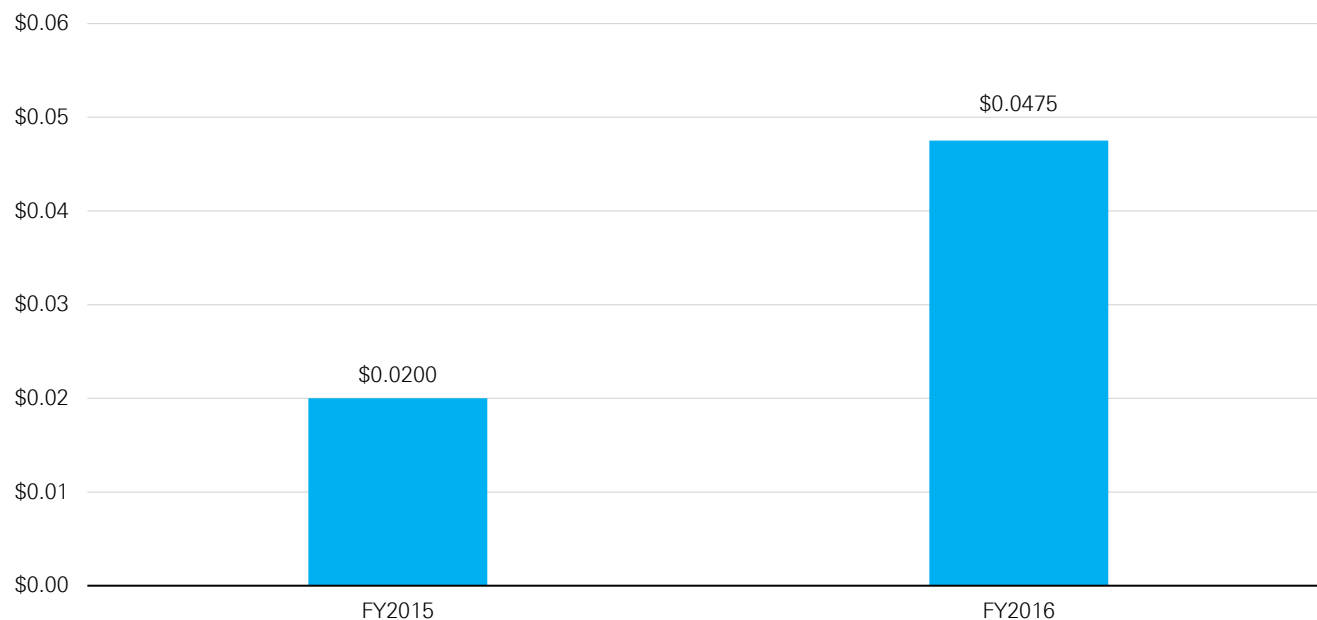
## Capital Management - Summary Data as at 31<sup>st</sup> October 2016

Share Price	\$1.15
Share Price Discount/Premium to NTA (Undiluted, Pre-Tax)	-7.26%
Historical Fully Franked Dividend Yield	4.13%
Historical Gross Dividend Yield	+5.90%
Shares on Issue	36,134,500
Options on Issue	6,865,500
Directors Shareholding	3,393,277

### Historical Shareholder Return Breakdown



### Dividend Profile – Historical Fully Franked Dividends (Cents per share)



### Description of Statistical Terms/Glossary

**Portfolio Weighted Market Capitalisation** – The portfolio weight of each individual position multiplied by each company's 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 Sharpe 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 less than 1 indicated that a security/portfolio should be less volatile than the market.

**XAOAI** – All Ordinaries Accumulation Index

#### Disclaimer:

This report has been prepared by NAOS Asset Management Limited. Information provided in this report is for general information purposes and must not be construed as investment 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 read the offer documents and should seek their own financial product advice. Returns are compounded for periods greater than 12 months. The Investment Manager of the Company is NAOS Asset Management Limited (ABN 23 107 624 126, AFSL 273529). NAOS Address: Level 34 MLC Centre, 19 Martin Place, Sydney NSW 2000. NAOS Telephone: 61 2 9002 1576

### CORPORATE DIRECTORY

#### Directors

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

#### Company Secretary

Julie Coventry

#### Investment Team

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

#### Chief Financial/Operating Officer

Richard Preedy

#### Business Development

Julia Stanistreet

#### Share Registry

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Facsimile: 1300 653 459

#### Investment Manager

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#### Auditor

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Sydney NSW 2000

#### Registered Office

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#### ENQUIRIES

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