

# NAOS Absolute Opportunities Company (NAC)

NAOS

## MONTHLY INVESTMENT REPORT AND NTA UPDATE

APRIL 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 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 0-30 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: 12<sup>th</sup> November 2014**

**Share Price at 30<sup>th</sup> April 2015: \$0.98**

**Benchmark: RBA Cash Rate + 250bps**

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

**Listed Options on Issue Exercisable at \$1.00 Prior 30<sup>th</sup> November 2016 (ASX: NACO): 21,500,000**

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

**Total Directors Shareholding in NAC: 937,958 Ordinary Shares**

### Net Tangible Asset Value Breakdown as at 30<sup>th</sup> April 2015

<b>Pre Tax NTA:</b>	<b>\$1.04</b>
<b>Post Tax &amp; Pre Unrealised Gains Tax:</b>	<b>\$1.03</b>
<b>After Tax NTA:</b>	<b>\$1.03</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

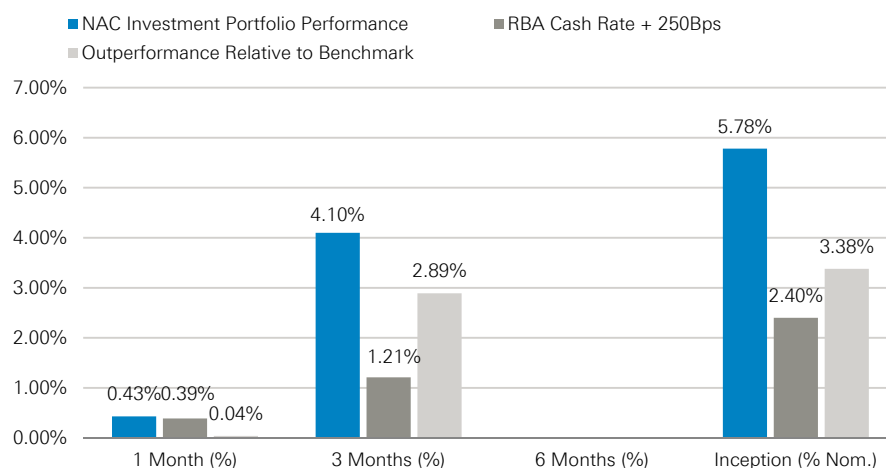
### Investment Portfolio Performance to 30<sup>th</sup> April 2015

NAC's Investment Portfolio posted a positive return for the month of April of +0.43% compared to the benchmark return of +0.39%.

Positive attribution came from our position in Amalgamated Holdings (+0.45%), and a newly entered position in the US AerCap (+0.21%). Negative contribution came from a new position in Europe, Hella KGaA Hueck & Co following a sell-off in the DAX as bond yields have been rising. Our long USD position versus AUD was also a negative contributor (-0.15%). Please refer to Portfolio Positioning commentary for further detail on key positions in the portfolio.

	1 Month	3 Months	6 Months	Inception (Nom.)
<b>NAC Investment Portfolio Performance*</b>	<b>+0.43%</b>	<b>+4.10%</b>	<b>N/A</b>	<b>+5.78%</b>
<b>Benchmark (RBA Cash Rate + 250bps)</b>	<b>+0.39%</b>	<b>+1.21%</b>	<b>N/A</b>	<b>+2.40%</b>
<b>Outperformance Relative to Benchmark</b>	<b>+0.04%</b>	<b>+2.89%</b>	<b>N/A</b>	<b>+3.38%</b>

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

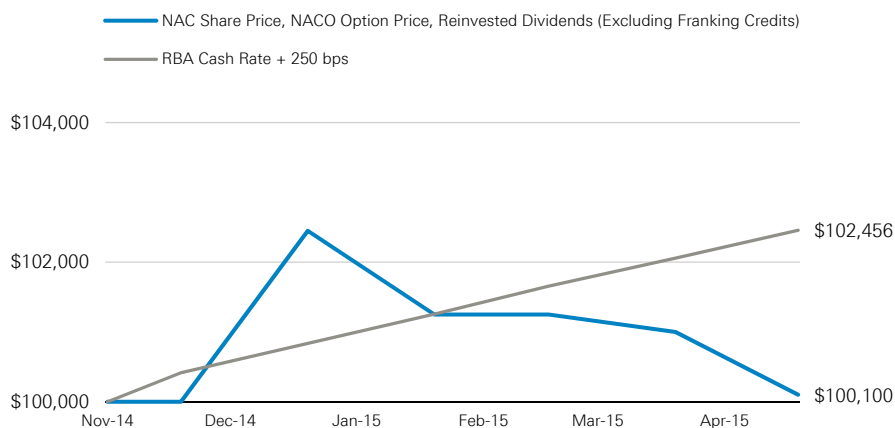


### Positive Stock Attribution Analysis (12<sup>th</sup> November 2014 to 30<sup>th</sup> April 2015)

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. All of the below may either have been a long or short position.

Investment	Contribution to Return (%NAV)	Investment	Contribution to Return (%NAV)
USD ETF	+3.86%	Village Roadshow Limited	+0.60%
Amalgamated Holdings Limited	+1.20%	Macquarie Atlas Roads	+0.45%
Iselect Limited	+1.16%	Reece Australia Limited	+0.41%
National Australia Bank Limited	+0.78%	Monadelphous Group Limited	+0.35%

### Shareholder Return Analysis (IPO Investors)



### Portfolio Characteristics – Summary Data

Total Number of Equity Holdings (Long & Short)	16
Total Number of "Income" Instruments	9
Total Number of Holdings	25
Median Market Capitalisation	\$3.30 Billion
Percentage of Positive Months (NAC)	83%
Percentage of Positive Months (XAOAI)	50%
Standard Deviation of Returns (NAC)	+2.35%
Standard Deviation of Returns (XAOAI)	+12.07%
Correlation of Returns to XAOAI	+0.0625
Sortino Ratio	+5.50
Current Estimated Portfolio Beta	+0.13

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

### Market Insight

April month end resulted in the Australian market having its second monthly decline in a row (-1.72%) and the ASX 200 struggling to break through the 6,000 mark. As equities have fallen, commodities have rallied. Oil and natural gas were both up big during the final week of April, and oil is now up for the full year.

In the US it was reporting season. According to FactSet, of the 360 companies that have reported earnings to date for Q1 2015, 71% have reported earnings above the mean estimate and 46% have reported sales above the mean estimate. US earnings growth for 1Q15, showed a decline of 0.4%. For Q2 2015, 41 companies have issued negative EPS guidance and 22 companies have issued positive EPS guidance, which highlights the difficulties facing Companies in that region.

In Europe, there was plenty of talk about bond yields on longer dated bonds with Bill Gross and Jeff Gundlach both telling the media that German 30 year bunds were the short of a lifetime. There was a subsequent sell-off in bonds which saw the yield spike, as seen in the chart below. At his May 2 AGM, Warren Buffett also made comment that he would short the German 30 year if there was an easy way to do it.

The chart below shows the history of the yield of the 30 year bund and how it spiked towards the end of the month (highlighted in red).



Given the events unfolding, as described above, the question we need to ask ourselves is what will be the effect on equity markets if yields continue to rally? Certainly the movement in bond yields will adjust the risk premium investors are taking with their equity investment. This could result in increased volatility in the equity markets in Europe in the short term. Short term volatility can provide opportunities for longer term investors and we believe this puts us in an attractive position to capitalise. Further detail of how the portfolio is positioned and what opportunities we are looking to capitalise on can be found in the Portfolio Positioning section of this report.

### Portfolio Positioning as at 30<sup>th</sup> April 2015

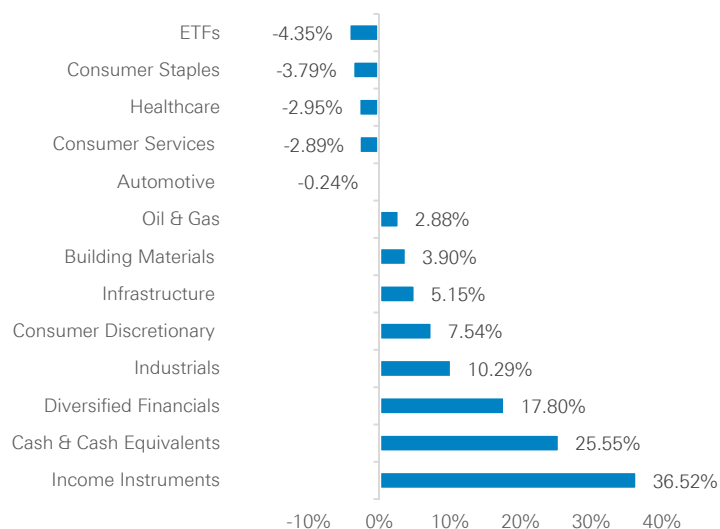
The portfolio continues to be defensively positioned given our concern over market valuations in some areas. Of the markets that we are closely following, China and Hong Kong were the best performers for the month followed by the UK and the S&P 500, with Germany's DAX Index the weakest after a strong start to the year.

During the period we made an investment in European lighting manufacturer Hella KGaA Hueck & Co (HLE GR). Hella is listed in Germany and is a market leader in LED headlamps for the auto industry. Automotive LED lighting is growing at 20-25% annually, a pace Hella is keeping up with, plus LED's have very low penetration levels and are starting to grow rapidly. Based on our analysis, Hella have a free cash flow yield of ~6-7% and are leveraged to five key themes including;

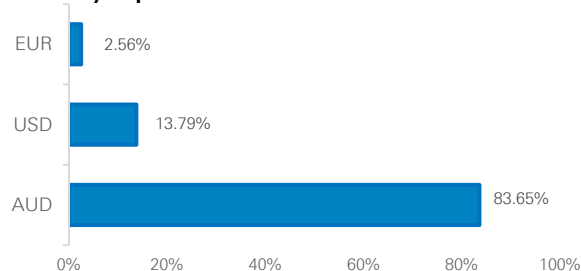
1. Lower oil prices making the cost of driving cheaper
2. A lower Euro makes their cars exports cheaper to the rest of the world
3. Car manufacturing is increasingly moving towards more energy efficient models through the use of LED lighting
4. Improving European economic data which could increase confidence
5. European QE which will support asset prices in the region

During the month we also added AerCap to the long side of our portfolio. AerCap is listed in the US (AER US) and in 2013 AER became the 2<sup>nd</sup> largest aircraft lessor behind GE Capital after the acquisition of ILFC (International Lease Finance Corporation). ILFC was sold by AIG as it was viewed as a non-core asset. After AIG was forced to take \$5bn asset impairments between 2010 and 2013, we believe the book was acquired at an attractive multiple. The acquisition also allows AER to increase their bargaining powers in bulk aircraft purchases which reduces the chance of residual risk, as well as access to an attractive order book of the latest fuel efficient planes from Boeing and Airbus. The company is currently deleveraging by selling older planes and looking to use the excess capital to pay off debt as well as conduct buybacks or introduce dividends.

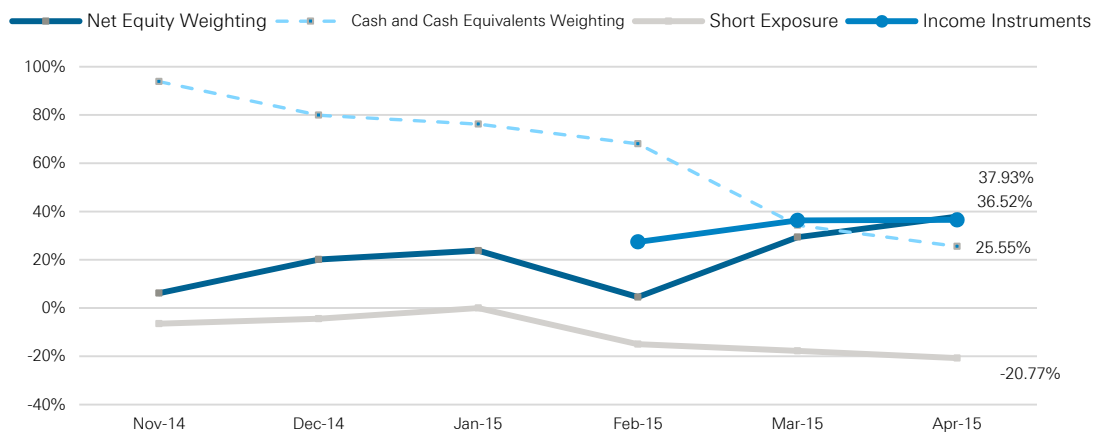
### Industry Exposure (Equity & Income Instruments)



### 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 Investment Management Team has contact with many listed and unlisted companies across a wide range of industries and geographies. During the month of April the NAOS Investment Team engaged with over 43 unlisted and listed companies, a selection of those met with is provided as follows.

- AerCap (AER US)
- James Hardie (JHX AU)
- Qantas (QAN AU)
- Pulte Group (PHM US)
- Zillow (Z US)
- DR Horton (DHI US)
- Macquarie Atlas Roads (MOA AU)
- G8 Education (GEM AU)
- Mortgage Choice (MOC AU)
- Adelaide Bright (ABC AU)
- GBST Holdings (GBT AU)
- Canadian Oil Sands (COS CN)

## 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

### 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

#### 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)