

NAOS Absolute Opportunities Company (NAC)

NAOS

MONTHLY INVESTMENT REPORT AND NTA UPDATE

OCTOBER 2015

KEY CHARACTERISTICS

1. Global, Multi Asset Class Exposure

NAC invests in a range of equity, fixed income, currency and commodity securities both in Australia and Offshore, providing significant scope for capitalising on performance generating ideas. Key themes are identified and analysed for their impact at the security level, allowing the Investment Team to take advantage of fluctuations and mis-pricing situations on a cross sector, asset class and geographic basis.

2. Positive Absolute Return & Income Generation Focus

The primary focus of the Company's investment strategy is the preservation of shareholders 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 31st October 2015

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

*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

Portfolio Performance & Positioning

The Naos Absolute Opportunities Company (NAC) returned +3.38% for the month of October.

Rather than once again commenting on the state of the markets which seem to be continuing their rollercoaster ride, we thought that we would provide some information relating to a new addition to the portfolio, and an update from the AGM of one of our core holdings, which we attended during the month.

The Irish Continental Group (ICG)

We initiated a new position in Ireland with a long holding in The Irish Continental Group (ICG). ICG is a shipping and transport group principally engaged in the transport of passengers, cars and freight on routes between Ireland, the United Kingdom and Continental Europe. ICG also offers inclusive package holidays to the Republic of Ireland and Britain. ICG has strong cash flows and in recent times has been winning a greater proportion of market share. We believe ICG is in a strong position to capitalise from a lower fuel price as well as from stronger economic growth in the region (as indicated by improving Housing and Tourism figures).

Reece Group AGM

During the month we attended the Reece Group AGM in Melbourne. Reece has been a core holding for us, almost since the inception of the Company. Most of our readers would know the business, being one of Australia's leading suppliers of plumbing products to customers in the trade, retail and commercial markets. We believe Reece is an exceptionally well run family business. In our view there are very few listed businesses of the same quality as Reece. During the AGM the Company stated that they were continuing to enjoy buoyant market conditions, with residential commencements moving to completions and renovations showing a return to growth. They also stated that their store footprint is double that of the last residential boom in 2003/4, delivering fixed store leverage and driving Reece's industry leading margins which we believe will drive further earnings growth.

	1 Month	3 Months	6 Months	Inception (Nom.)
NAC Investment Portfolio Performance*	+3.38%	+3.99%	+7.71%	+13.92%
Benchmark (RBA Cash Rate + 250bps)	+0.40%	+1.17%	+2.39%	+4.84%
Relative Performance	+2.98%	+2.82%	+5.32%	+9.08%

S&P/ASX All Ordinaries Accumulation Index (XAOAI)	+4.59%	-5.47%	-6.24%	+1.04%
MSCI ACWI AC (Net, Div Reinvested, AUD Terms)	+5.72%	-1.03%	+5.37%	+21.49%

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

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

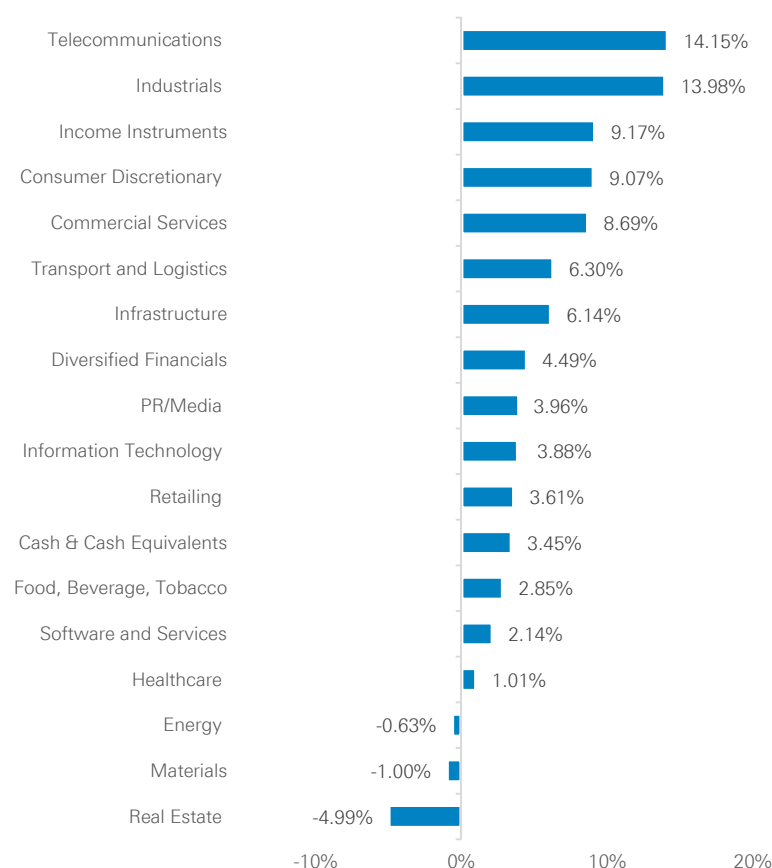
Below is a table listing the top positive contributors to NAC’s total return since inception. The purpose of the table is to illustrate that the performance the investment team derive over time is not simply from one or two positions, but from a variety of positions, even with a concentrated portfolio of investments that is generally limited to 0-30 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	+6.34%	Iselect Limited	+1.48%
Sirtex Medical Limited	+2.75%	Moleskine SpA	+0.77%
Amalgamated Holdings Limited	+2.76%	Sealink Travel Group	+0.72%
Macquarie Atlas Roads	+1.80%	Bellamy’s Australia	+0.69%

Portfolio Analysis as at 31st October 2015

As at 31st October the portfolio comprised of 34 holdings, including 22 long equity positions, 7 short equity positions and 5 income instruments. The portfolio was geographically concentrated (based on net currency exposure) in Australia (~72%) however we also maintained an exposure to the US (~9.8%), Europe (~9%), New Zealand (0.5%) and Hong Kong (~-1%).

Net Industry Exposure



Market Insight

To help understand what is happening in global markets and why it is such a difficult time to invest money, it is interesting to explore the gravitational tug of war going on in economies around the world.

Looking at Australia, we will single out the oil and gas sector. Throughout calendar year 2014, the price of oil fell from over US\$100/barrel to less than US\$50 in a very short time frame, providing very little time for companies within the oil and gas sector to adjust their operations and, more importantly, their cost bases, to meet the changing landscape. With cost overruns and forecast guidance marked down multiple times, to the point where it was all but thrown out the window, it was no surprise to see stock prices of companies in the sector fall through the floor. Downward price pressure was further exacerbated by hedge funds looking to make money by short selling. During calendar year 2015, the price of oil has stabilised and traded in a range between \$40 and \$60.

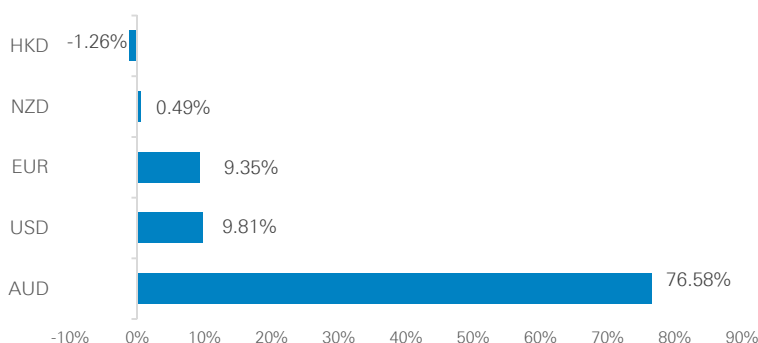
Looking at market movements/activity in October; given that the sector has been an easy place to make money on the short side, short interest positions were extremely elevated at the commencement of the month. At the same time, just as pessimism was close to its peak, the M&A activity started. The four best performing stocks this month were in the energy sector; being Drillsearch, Santos, Paladin and Beach Energy. Drillsearch and Santos, were the best performers, producing monthly returns of +55% and +40% respectively.

The difficulty when investing your money in the market, and particularly on the short side, is that often your thesis can be right but you can lose a fortune on the trade. Taking the example of Santos, the situation for them was looking dire and it seemed more likely that they would need to raise capital at a highly discounted price (think Origin Energy during recent times). Anyone short the sector going into the month would have done a lot of damage to their portfolio. It serves as a timely reminder that when consensus is so far to one extreme, the opposite outcome can be fatal. Andy Redleaf from Whitebox funds made an excellent comment on the topic when he said;

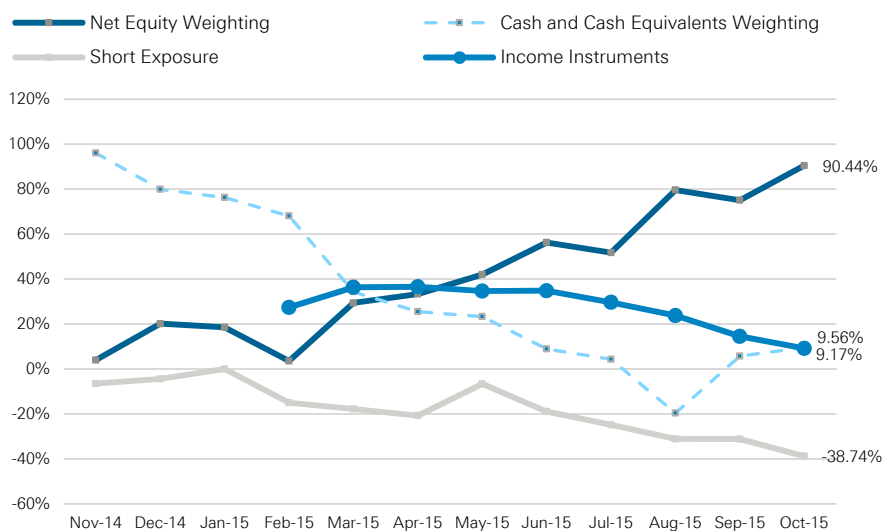
“Betting against the infinite extension of a happy trend is a terrific way to make money. Even better in my experience is to bet against the infinite extension of an unhappy trend” Andy Redleaf

***NB: Post the time of writing Santos announced a 1:2 entitlement offer. Maybe the shorters can regain some performance in November!**

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

- Reece Australia Limited (REH)
- Kathmandu Holdings Limited (KMD)
- Smart Group Corporation (SIQ)
- Corporate Travel Management (CTD)
- Iselect Limited (ISU)
- AP Eagers Limited (APE)
- Burson Group Limited (BAP)
- Pulte Group (PHM US)
- VF Corporation (VFC US)
- Columbia Sportswear Co (COLM US)
- Sketchers USA (SKX US)
- My Net Fone Limited (MNF)

Market Insight Continued

Looking across to the performance of the US markets, the consumer seems to be doing all of the heavy lifting. By way of example, Nike recently reported that order growth was +17% which is close to their highest rate of growth in a decade, while McDonalds also reported a stronger than expected quarter.

There have been numerous articles recently talking about the difficulties that employers have been facing in attracting people to work for them and as a result are having to increase their average wages. Wage inflation in the US is a topic we have talked about previously and it looks like we could be seeing the beginning of it. US Payrolls data for the month of October came in at a whopping 271,000 vs the consensus estimate of 185,000.

In an article posted by The Wall Street Journal it was reported that “Toys “R” Us Inc. is giving part-time employees the chance to double their hours compared with a year ago. Macy’s Inc. is looking to turn more part-time jobs into full-time positions and Target Corp is offering holiday workers more money for the busiest shifts. This is a great sign for the US economy in our view and will give the Fed more reason to justify an increase in the Federal Reserve funds rate by 25 basis points.

The housing market in the US is also a sector we have exposure to. During the month, New Home Sales came in weaker than expected and as a result, the sector sold off. Even though the September report was disappointing, sales are still up solidly year on year and we believe our thesis is still intact.

Portfolio Characteristics – Summary Data as at 31st October 2015

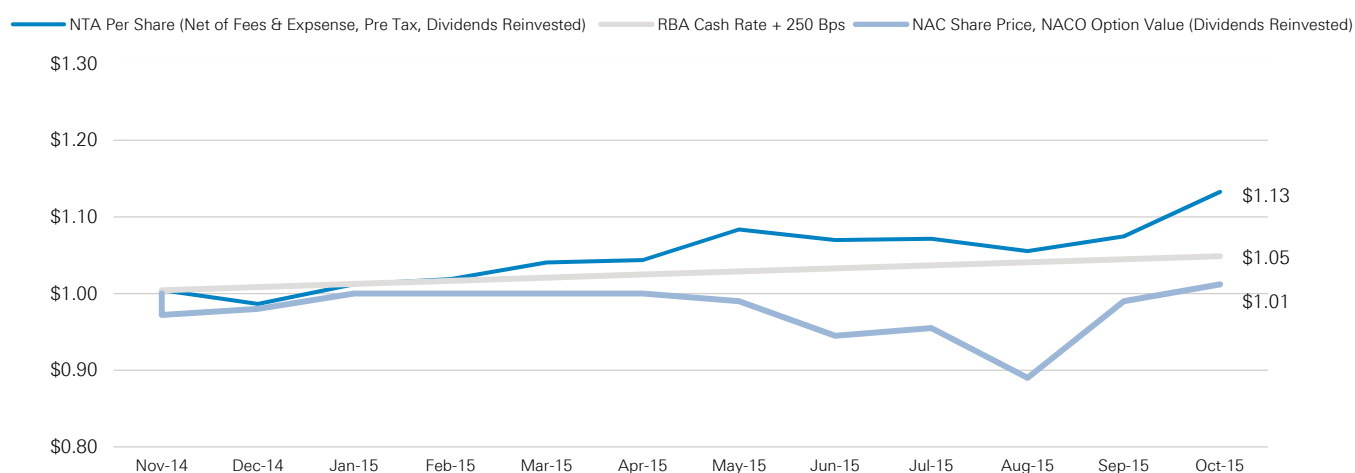
Total Number of Equity Holdings (Long & Short)	29
Total Number of Income/Debt Instruments*	5
Total Number of Holdings	34
Portfolio Weighted Market Capitalisation (AUD)	\$13.8bn
Percentage of Positive Months (NAC)	75%
Percentage of Positive Months (XAOAI)	50%
Standard Deviation of Returns (NAC)	6.91%
Standard Deviation of Returns (XAOAI)	14.09%
Correlation of Returns to XAOAI	40.98%
Sortino Ratio	33.11
Downside Deviation	0.44%
Downside Deviation (XAOAI)	8.16%
Current Estimated Portfolio Beta	0.26

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

Capital Management - Summary Data as at 31st October 2015

Share Price	\$0.98
Share Price Discount to NTA (undiluted, pre tax)	9.26%
Fully Franked Dividend Yield	4.12%
Gross Dividend Yield	5.89%
Shares on Issues	21,500,000
Options on Issue	21,500,000
Directors Shareholding	1,539,878

NTA & Share Price Analysis



Description of Statistical Terms/Glossary

Portfolio Weighted 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 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 (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

Julie Coventry

Investment Team

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

Chief Finance/Operating Officer

Richard Preedy

Business Development Team

Anneke Senden
Julia Stanistreet

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
jstanistreet@naos.com.au
www.naos.com.au