

# NAOS Emerging Opportunities Company (NCC)

NAOS

## MONTHLY INVESTMENT REPORT AND NTA UPDATE

SEPTEMBER 2015

### KEY CHARACTERISTICS

#### 1. Genuine Exposure to Undervalued Emerging Companies

Regardless of market capitalisation and/or liquidity, NCC seeks to provide investors with exposure to high quality emerging companies in a transparent and concentrated long/short structure that has the competitive advantage of being a nimble closed end fund with no liquidity constraints.

#### 2. Focus on Quality of Companies not Quantity of Companies

Our primary focus is on developing a deep understanding and appreciation of the companies in our portfolio. We believe the best way to achieve this is to focus on a select (target 0-15) number of high quality ideas. By developing a solid understanding of these companies we believe we are well positioned to capitalise on our 'information advantage'.

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

We target an Internal Hurdle Rate of 20% p.a. over a rolling three year period for all our investment holdings.

#### 4. Constructing the Portfolio Utilising a Benchmark Unaware Approach

Being benchmark unaware means we are not forced holders of stocks with large benchmark weightings that we are not convinced are attractive investment propositions.

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

NAOS employees/directors own >\$10m NCC shares providing shareholders with a significant alignment of interests.

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

<b>Pre Tax NTA:</b>	<b>\$1.05</b>
<b>Post Tax &amp; Pre Unrealised Gains Tax:</b>	<b>\$1.05</b>
<b>After Tax NTA:</b>	<b>\$1.06</b>

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

The NCC investment portfolio produced a positive return of +0.86% for the month of September. The portfolio's benchmark, the XSOAI (Small Ordinaries Accumulation Index), fell by -0.53% over the same period, interestingly the smaller indices once again outperformed the larger All Ordinaries Index (XAOAI) which fell by -2.50% over the same period. Over the last six months the XSOAI is down by -7.78% and XAOAI has fallen by -11.68% highlighting the significant selling pressure on the big four banks, BHP and RIO over this period.

Since the portfolio's inception on 26<sup>th</sup> February 2013 (31 months), the relative outperformance of the portfolio versus the benchmark is +53.34%.

Domestic equity markets capped off a horror quarter with the ASX-200 finishing down -15% for the three month period. Poor market performance in September was driven by a number of key economic and market events including; The Federal Reserve not raising interest rates due to two 'one-off' events affecting inflation levels, worries about slowing global economic growth driven by emerging markets, namely China and falling commodity prices leading to fears of global deflation.

From a risk perspective, the key indicators NAOS consider are government bond yields, corporate bond yields and CDS spreads. Government bond yields have stabilised if not moved lower over the past month, the JUNK bond ETF has fallen but recently made retracement to \$35.80 compared to \$26.40 in the midst of the GFC. The one concern with junk bonds is that corporate spreads have increased significantly potentially implying there is a risk that these companies may not be able to service their debts when interest rates do rise. Finally, CDS spreads are the clear outlier, with the CDS spreads (a measure of pricing insurance against company debt) moving higher for a number of large multinational companies including Commonwealth Bank, Wells Fargo and HSBC. Overall we believe that debt markets continue to act in a relatively benign but there are signs that investors should continue to watch debt markets closely for any further deterioration in corporate spreads and/or CDS spreads.

	1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	Inception (p.a.)	Inception (nom.)
<b>NCC Investment Portfolio Performance*</b>	<b>+0.86%</b>	<b>-2.79%</b>	<b>-4.56%</b>	<b>-5.18%</b>	<b>+3.80%</b>	<b>+15.14%</b>	<b>+44.06%</b>
<b>S&amp;P/ASX Small Ordinaries Accumulation Index (XSOAI)</b>	<b>-0.53%</b>	<b>-3.90%</b>	<b>-7.78%</b>	<b>-4.90%</b>	<b>-2.52%</b>	<b>-3.69%</b>	<b>-9.28%</b>
<b>Outperformance Relative to Benchmark</b>	<b>+1.39%</b>	<b>+1.11%</b>	<b>+3.22%</b>	<b>-0.28%</b>	<b>+6.32%</b>	<b>+18.83%</b>	<b>+53.34%</b>

\*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. Since inception (p.a and nom.) includes part performance for the month of February 2013.

### Positive Stock Attribution Analysis (1st March 2013 to 30<sup>th</sup> September 2015)

The table below lists the top positive contributors to NCC’s total return since 1<sup>st</sup> 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 in the portfolio at some point in time.

Investment	Contribution to Return (%NAV)	Investment	Contribution to Return (%NAV)
Calliden Group Limited	+10.53%	Broadcast Services Australia	+5.55%
Capitol Health Limited	+10.23%	Village Roadshow Limited	+5.54%
Lindsay Australia Limited	+6.75%	Sirtex Medical Limited	+5.53%
Tamawood Limited	+5.86%	RHG Limited	+4.78%
Armidale Investment Corporation	+5.59%	Gage Road Brewing	+4.20%

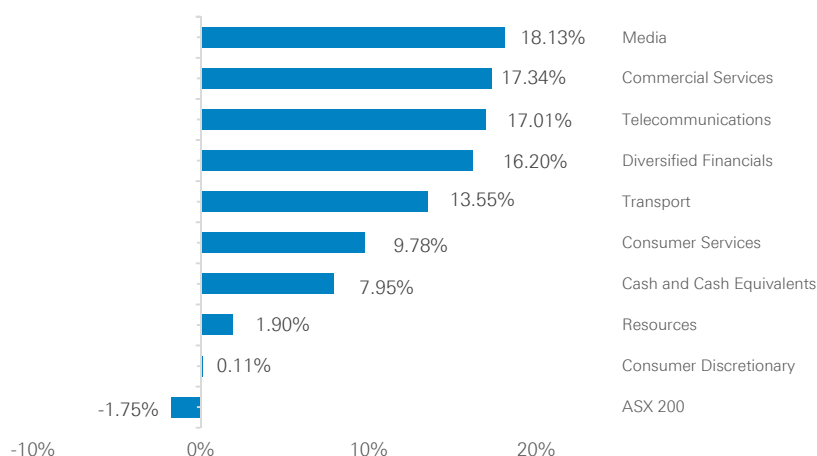
### Portfolio Positioning as at 30<sup>th</sup> September 2015

As at September month end, the portfolio’s net equity exposure was ~92% with a subsequent cash weighting ~8%. The portfolio was comprised of 10 holdings, 9 on the long side and 1 on the short. There were no income instruments in the portfolio.

Investment opportunities are assessed with the view that they should attain an average return of 20% p.a. over a three-year period. We have a high degree of conviction in relation to all positions in the portfolio with the current ‘top-5’ holdings in the portfolio at this time comprising > 60% of the portfolio’s total net tangible assets. The current ‘top 5’ holdings in the portfolio remained stable over the month of September and include Enero Group, Broadcast Services Australia, My Net Fone, Armidale Investment Corporation and Lindsay Australia.

As per August’s Monthly Investment Report, we will update shareholders with any major company specific news/events, which may give, rise to changes in the portfolio as and when they arise.

### Industry Exposure



### Investment Profile;



Enero is a boutique network of marketing and communications businesses. Some of the key brands in the Enero stable include; BMF, Frank, Hotwire, Naked Communications, The Leading Edge, Dark Blue Sea, Precinct, The Digital Edge OB Media, and Jigsaw. The Group operates out of three main hubs, being Sydney, New York and London.

### Company Background

Enero formerly operated as Photon Group. Photon Group was an ASX listed business that undertook large scale, rapid, agency acquisitions with high levels of gearing. In 2008, Photon’s strategy came to a head and the business was forced to undergo a wholesale restructure, leading to a rationalisation of the agencies operating under the renamed Enero banner.

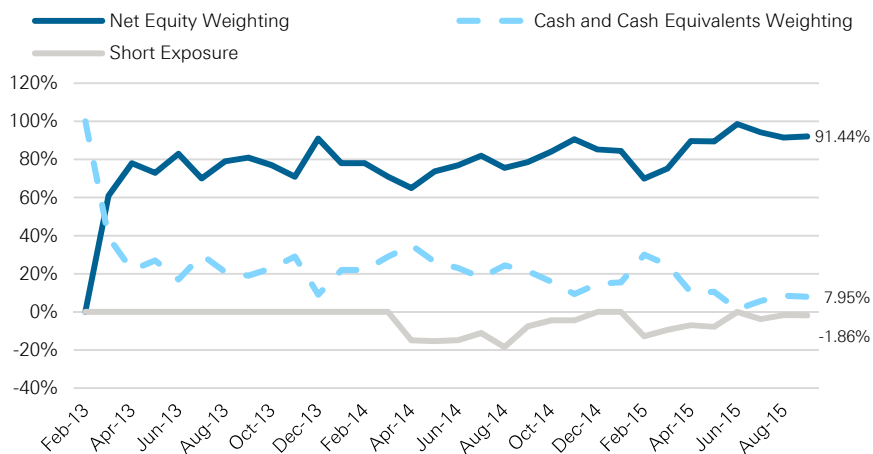
In 2012, post the completion of the restructure, a new CEO for the Group was sought. Matt Melhuish, co-founder of BMF (one of the core agencies remaining in the Enero stable) was appointed into the role. BMF started with just 3 employees that grew into a leading creative agency with >180 employees and was voted Australian agency of the decade in 2010. BMF’s current clients include P&O Cruise Lines, XXXX Beer, Aldi Supermarkets and Sports Bet.

Today Enero’s agencies focus on four main markets; Technology PR - through Hotwire (best technology agency worldwide by The Holmes Report), Consumer PR - through Frank (top-5 UK consumer agency for over a decade), Creative - through BMF and Naked Communications and Marketing Research - through The Leading Edge, who recently completed major work for McDonalds, AB Inbev and Westpac.

### Positioning and Outlook

As a result of the company restructure, Enero is unable to pay dividends or complete share buybacks until late in the financial year 2017. As such, the net cash position of the business has grown to a substantial amount, \$25 million and the company is debt free. Continued ....

**Net Equity Exposure**



**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. A selection of the companies met with during the month of September is provided below.

- Sea Link (SLK)
- Redhill Education (RDH)
- Indoor Skydiving (IDZ)
- Data 3 (DTL)
- RCG Corp (RCG)
- Vocation (VET)
- Bellamy’s Australia (BAL)
- Auswide Bank (ABA)
- 360 Capital (TGP)
- Adelaide Brighton (ABC)
- Australian Wealth Investment (AWI)
- Gale Pacific (GAP)

**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.

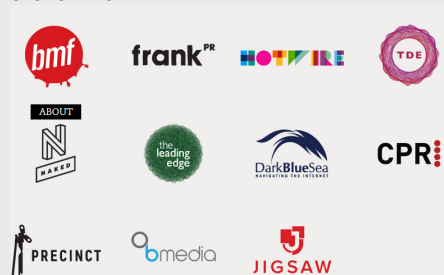
Portfolio Weighted Market Capitalisation	\$93m
Percentage of Positive Months (NCC)	69%
Percentage of Positive Months (XSOAI)	50%
Standard Deviation of Returns (NCC)	11.84%
Standard Deviation of Returns (XSOAI)	14.28%
Correlation of Returns to XSOAI	57.20%
Sortino Ratio	2.16
Downside Deviation	5.78%
Downside Deviation XSOAI	7.68%
Current Estimated Portfolio Beta	0.22

Over the last three years of restructuring and simplifying there has been a focus on margin improvement (now >8%) and less of a focus on the revenue line, which has fallen some 12% over the same period. We believe Eneo will be able to maintain, if not grow, the revenue base and increase margins back to global industry standards (between 12-18%). The business has also hit some key business development targets over the period, such as winning the Ebay account in Europe to manage all social media and online content.

From a geographic standpoint, over half of Eneo’s revenue base is now derived from Europe and the US, which arguably have brighter economic outlooks than the Australian domestic economy. More importantly, these geographies offer a much larger pool of opportunities for Eneo’s key brands such as Hotwire, Frank PR and Naked Communications.

Focusing on the industry dynamics, the introduction and growth of new media mediums, particularly social media, has forced companies today to be more effective in the way they communicate and distribute their message. Big data is becoming more of a focus for businesses and the poor return on investment shown from many forms of digital advertising has forced companies to review their digital advertising strategies. Many companies do not have the expertise in house and hence the need to outsource to specialist service providers in this field has become significantly more important. We believe this trend will continue for some time to come which places businesses like Eneo in an advantageous position to capitalise.

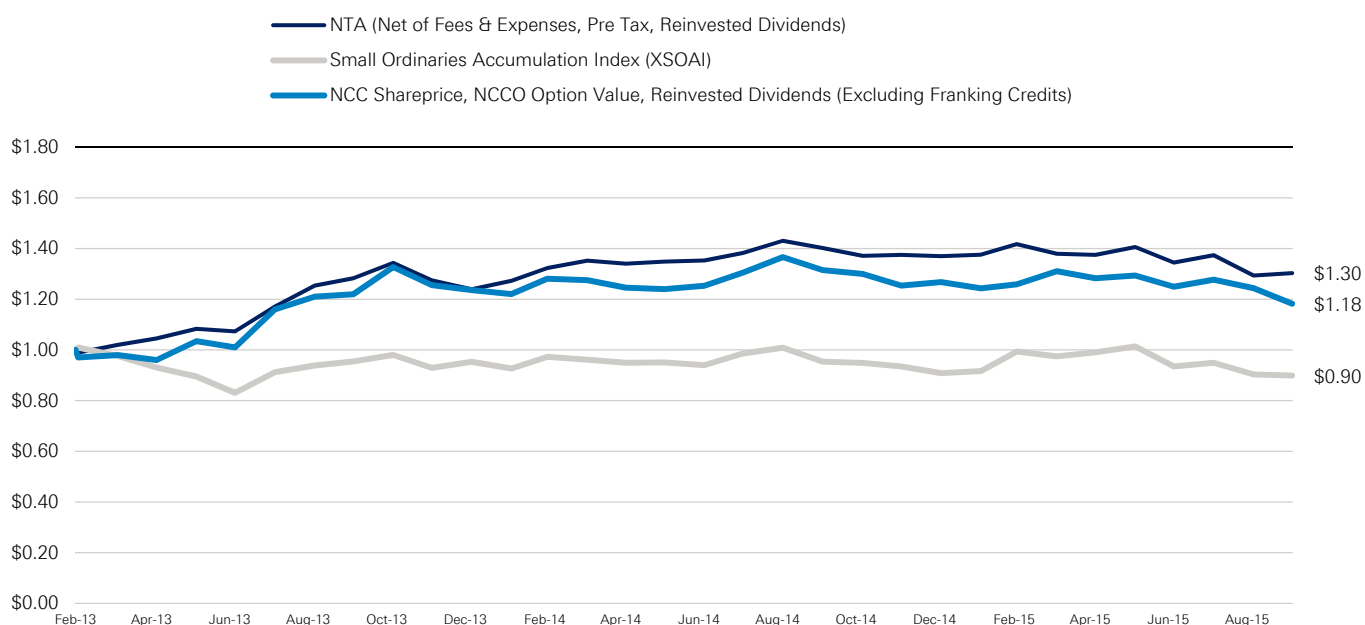
Examples of the work completed by the businesses comprising the Eneo Group can be found on their respective websites. I’m sure many of you will be surprised by how much of the work you recognise and are familiar with.



**Capital Management – Summary Data as at 30<sup>th</sup> September 2015**

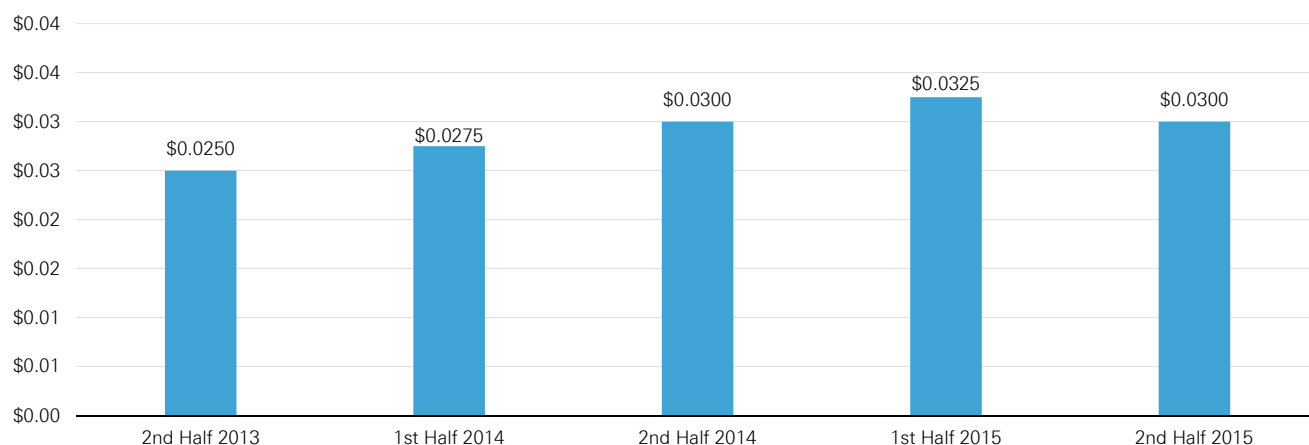
Share Price	\$0.935
Discount to NTA (pre tax, undiluted)	11%
Fully Franked Dividend Yield	6.42%
Gross Dividend Yield	9.17%
Shares on Issues	46,918,297
Directors Shareholding (ordinary shares)	3,210,079

**NTA Per Share (Net of Fees & Expenses, Pre Tax) vs Small Ordinaries Accumulation Index (Dividends Reinvested) & NCC Share Price, Option Value, Reinvested Dividends (Excluding Franking Credits)**



\*Assumes an intrinsic NCCO value of \$0.14 cents per option at expiry (1st February 2015).

**Dividend Profile - Historical Fully Franked Dividends (Cents per Share)**



## Description of Statistical Terms/Glossary

**Portfolio Average 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 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 Ratio may potentially indicate that there is a low probability of a large capital loss. Returns less than that of the benchmark (RBA Cash Rate+ 250 Basis Points) are classified as negative asset returns.

**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.

**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

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Julia Stanistreet

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#### ENQUIRIES

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