Monthly Report April 2014

Ralton High Yield Australian Shares

Winner of the 2010 Standard & Poors' Fund Awards
- Separately Managed Accounts Category

Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Ralton High Yield Australian Shares model portfolio is a separately managed account, or SMA, actively managed by Ralton Asset Management (Ralton). SMAs are professionally managed portfolios of direct shares whereby the investor receives beneficial ownership of the underlying securities.

Investment Objective

The objective of the Ralton High Yield Australian Shares SMA is to provide investors with consistent, tax-efficient and growing cash dividend yield, and long-term capital growth. The Portfolio aims to deliver a return superior to that of the market over periods of five years or longer and an above market yield.

Key Portfolio Features	
Inception	1 February 2008
Benchmark	S&P/ASX 300 Accumulation Index
Authorised Investments	Companies in the S&P/ASX 300 Index or those amongst the top 300 by size.
Number of Stocks	20-35
Cash Allocation	0% to 10%
Tracking Error	2% to 5%
Investment Horizon	At least 5 years
Ratings	

The Portfolio is designed for investors who...

- Seek an above market, tax-efficient cash dividend yield and long term capital growth
- Expect consistent above market returns
- Have a long term investment horizon of at least five years and accept the risk of equity markets

Portfolio Structure

No.	Company Name	ASX Code
1	ANZ Banking Group	ANZ
2	Commonwealth Bank of Australia	CBA
3	Telstra Corporation Limited	TLS
4	Westpac Banking Corporation	WBC
5	BHP Billiton Limited	BHP
6	Woodside Petroleum Limited	WPL
7	Amcor Limited	AMC
8	Sonic Healthcare Limited	SHL
9	Origin Energy Limited	ORG
10	Sydney Airport	SYD

GICS Sector	Ralton	Index	+/-
Industrials	11.4%	7.1%	4.4%
Telecommunication Services	7.5%	5.3%	2.2%
Consumer Discrectionary	7.0%	5.7%	1.3%
Energy	7.7%	6.6%	1.1%
Financials (ex-Property)	36.0%	35.6%	0.4%
Utilities	2.3%	2.0%	0.2%
Information Technology	0.0%	0.9%	-0.9%
Health Care	3.5%	4.8%	-1.3%
Materials	15.5%	17.3%	-1.8%
Property	4.5%	7.0%	-2.5%
Consumer Staples	4.6%	7.6%	-3.1%
Total	100%	100%	

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton High Yield	1.00	6.35	12.52	12.78	14.71	7.03
Income Return	0.00	1.46	4.48	5.04	4.87	5.08
Growth Return	1.00	4.89	8.04	7.74	9.84	1.95
S&P/ASX 300 Acc. Index	1.68	6.91	10.14	8.77	12.32	3.94
Difference	**-0.68**	**-0.55**	**2.38**	**4.01**	**2.39**	**3.09**

*Since Inception p.a., Feb 2008

Month in Review

- The S&P/ASX 300 made solid gains, moving 1.68% higher, with Property Trusts and Energy the best performing sectors in percentage terms.

- The Ralton High Yield Model Portfolio also delivered a positive return, adding 1.00%, underperforming the benchmark index by 0.68%.

- At a sector level, the portfolio's exposure to Healthcare added value, however our stock selection within Consumer Staples detracted from performance.

Portfolio Commentary

Month Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Sky Network Television	Overweight	QBE Insurance	Overweight
Origin Energy Ltd	Overweight	Coca-cola Amatil	Overweight
Duet Group	Overweight	Goodman Fielder Ltd	Underweight

Positive Contribution

New Zealand-based Sky Network Television (SKT, +4.4%) was the portfolio's top performer for the month. The stock is now up 31.6% over the 12 months to date, and furthermore has moved about 50% higher since the sell-down by News Corporation in March 2013. The strength in the share price shows the market continues to gain an appreciation of the quality of the broader business and it's monopoly position in the NZ pay TV market, supported by the ongoing strength of the NZ economy.

For Origin Energy (ORG, +4.1%), the company's most recent quarterly production report in April confirmed that the company's Gladstone based LNG plant, known as APLNG, is now nearly 70% complete. We expect that as Origin Energy advances this project, investors will focus increasingly on the cash flows it will generate. With several LNG projects set to commence production shortly, the rise in demand for Australian gas to fuel these plants, together with the direct link that these gas plants will provide with global oil prices, will see the price of domestic gas rise. Whilst this is certainly a negative for most businesses and consumers in Australia, companies who are 'long gas' should benefit. Origin's annual sales of gas are circa 200 PJ and, as a low cost producer and purchaser of gas, the company should, we believe, benefit from rising prices.

Negative Contribution

QBE Insurance (QBE, -9.7%) reversed its positive start to the calendar year during April. Contributing to the weakness was the ongoing strength of the Australian dollar, (which of course impacts translation of US dollar profits), together with declining government bond yields, which impacts QBE's investment returns and the value of its liabilities. In the short term it appears that bond investors are tempering their view of the US growth outlook following a severe winter that has weakened economic activity in the US. At it's AGM, QBE also announced a 'strategic review' of its US middle market business. This will likely see the company sell this business and we view this as a postive given its subscale operations.

Goodman Fielder (GFF) was sold from the portfolio in early April, following a further profit downgrade. Under relatively new management, the company has made strong progress in selling off non-core assets and improving pricing structures with its customers in their key baking division. These savings were however offset in the first half by increased costs to maintain service standards to customers. GFF explained that network rationalisation across their manufacturing plants had lead to production supply issues, which in turn had forced them to increase costs to meet demand and service standards. Our confidence in GFF was however further dented by another profit downgrade early in April. Although several factors contributed to this latest profit revision, GFF noted that ongoing manufacturing shortfalls had again necessitated additional costs to meet service standards. At this point we sold the stock, having lost faith that management were in control of the business.

Coca-Cola, (CCL, -16.1%) also detracted from portfolio performance during April, although most of the fall came after we had significantly reduced the portfolio weighting. CCL has faced substantial headwinds over the past couple of years. These related to increased competition from a Japanese-controlled competitor (lacking profit discipline), de-stocking by the major supermarkets, a soft consumer environment and cost increases in Indonesia arising from a decline in the value of the rupiah and a rise in the minimum wage. In addition, there are rising health concerns about sugar consumption (i.e. is this the next tobacco?). If the health concerns are a factor, we think it will be a long time before it significantly dents consumption. At the time we acquired the initial holding we expected a number of these headwinds would ease in CY14. We reduced our holding in early April after revising our expectations regarding the timing of this.

Later in the month, CCL's new CEO Alison Watkins surprised us with a dramatic downgrade in current year earnings expectations. We are of the view that some of this downgrade is a re-basing of earnings to give the new CEO room to manoeuvre when making some structural changes in the company. Also, there is a recognition that the competition from Schweppes, the soft domestic consumer environment, and Indonesian pressures will all persist in the short-term. We are still a fan of the products CCL produces, the financial returns it has generated over a long period of time, and the growth options presented by Indonesia, and we expect it will get back on the path of profit growth. So we will continue to monitor the progress of Alison Watkins as she conducts a restructure of operations, with a view to adjusting the portfolio weight further at an appropriate time.

Portfolio Adjustments

During the Month we...

SOLD: ASX Limited (ASX), G8 Education Limited (GEM), Goodman Fielder Limited(GFF)

BOUGHT: Lend Lease Group (LLC), Macqurie Group Limited (MQG)

Purchases

We added two new stocks to the portfolio, namely LLC and MQG, both of which we consider as likely beneficiaries from either asset sales or a targeted boost to infrastructure investment, as flagged by the Federal government.

For Lend Lease (LLC) we are attracted to the multi-disciplinary, vertically integrated business model. This allows LLC to make profits across construction, property development, property ownership and long term property management (typically via investment funds). Although the pipeline of projects (and profits) for LLC out to 2015 has looked solid for some time, recent project wins, together with the likelihood of a rebound in government and private investment in Australia beyond this time frame, has strengthend our conviction around the length of this cycle. The outlook for LLC's global business operations has also improved and could well provide the next avenue for growth.

We also added a new position in Macquarie Group Limited (MQG). Since the Global Financial Crisis, MQG has shifted its business model and profit mix, and now receives a far higher percentage of its earnings from annuity type businesses such as funds management. However, the earnings from the more transactional businesses of FICC, investment banking and securities have contined to be a drag. We are now seeing signs of life for investment banking in the US and Asia with good volume lifts in the last half. Further, the pending sales by state governments of infrastructure assets should provide a string of opportunities in the Australian market. Finally, the wind down of US Fed QE3 should see a rise in volatility globally which can be a positive for FICC businesses.

Disposals

We also sold out of three stocks during the month, namely ASX Ltd (ASX), G8 Education (GEM) and Goodman Fielder (GFF), the last of which we have already discussed.

We sold the position in ASX during the month to deploy the proceeds into the MQG holding. Whilst we still like the ASX business model, it does face some headwinds given the volume growth for equities and derivatives continues to be subdued.

With G8 Education, we have made very strong gains from this stock, both in the last quarter and the last year. Recent sizeable acquisitions by the group, as discussed in our March quarterly report, boosted both the number of childcare centres under management and as a result forecast group profit. The recent share price rally took it beyond our assessed valuation for the company so we decided to exit the position.

RALTON
ASSET MANAGEMENT

Investment Approach

A Three Stage Investment Process

Intensive bottom-up research is the cornerstone of the entire process, supplemented by top-down economic and thematic views. The process is disciplined and consistently applied, using a number of proprietary qualitative and quantitative techniques to ensure that targeted companies have been thoroughly scrutinised. The aim is to uncover undervalued businesses. The companies that Ralton typically invests in are those with strong and reliable management, good profit and dividend growth expectations, reasonably predictable future profits and cash flows, and a very clear business model.

Stage 1: Defining the Investment Universe (Screening)

The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

Stage 2: Bottom-up Fundamental Company Research

Ralton's research programme is focused on understanding the key drivers of business performance and returns, namely people, operations, products and services, and market dynamics. For companies remaining in the Investment Universe, a detailed assessment is made of executive management, interviews competitors and suppliers, reviews financials, and forms a clear view on the outlook for the company's industry.

Stage 3: Portfolio Construction

Risk management and capital preservation are key themes underlying the portfolio construction framework. With a focus on actively managing down-side portfolio risk for investors, Ralton constructs an efficiently diversified portfolio of high quality, undervalued companies, and invests for the long term (typically 3 to 5 years) in an effort to maximise after tax-returns.

About the Manager

Ralton Asset Management is part of the OC Group, a boutique investment specialist majority owned by members of its investment team and key executives.

Ralton is a Value manager with a fundamental investment approach designed to identify quality businesses trading at a considerable discount to valuation. The process is guided by three fundamental beliefs:

- Markets are not perfectly efficient and the true value of a business is not always reflected in its share price;
- Undervalued companies can be identified through detailed and intensive research; and
- Capital preservation is critical to wealth creation.

The Investment Team

Andrew Stanley *BEc, LLB, ACA, FFin, MA AppFin*
Portfolio Manager, Ralton Model Portfolios

Andrew Stanley is the lead portfolio manager for the Ralton portfolios. He is supported by a dedicated and highly experienced team of investment professionals each with an average 18 years investment experience. Andrew has been working in financial markets for more than 19 years, including the past 5 years managing the Ralton portfolios. Prior to Ralton, he was an Executive Director at UBS in Hong Kong, and over the course of his career has held senior positions with major investment institutions in Melbourne, Hong Kong, Tokyo and New York. Andrew started his career at Arthur Andersen in Melbourne.

Roger Walling *BOptom, MBB* Portfolio Manager, Ralton Model Portfolios

Stephen Evans *B Com, ACA*, Portfolio Manager

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