Monthly Report May 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	

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton High Yield	1.33	3.75	17.51	13.99	14.73	7.15
Income Return	0.49	0.96	4.82	5.20	4.98	5.09
Growth Return	0.83	2.79	12.69	8.79	9.75	2.06
S&P/ASX 300 Acc. Index	0.65	2.55	16.12	9.75	12.14	3.99
Difference	**0.68**	**1.19**	**1.39**	**4.24**	**2.59**	**3.16**

**Since Inception p.a., Feb 2008*

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	Commonwealth Bank of Australia	CBA
2	Telstra Corporation Limited	TLS
3	ANZ Banking Group	ANZ
4	Westpac Banking Corporation	WBC
5	BHP Billiton Limited	BHP
6	Woodside Petroleum Limited	WPL
7	Amcor Limited	AMC
8	Recall Holdings Limited	REC
9	Sonic Healthcare Limited	SHL
10	Sydney Airport	SYD

GICS Sector	Ralton	Index	+/-
Industrials	14.2%	7.0%	7.2%
Telecommunication Services	8.2%	5.3%	2.9%
Consumer Discrectionary	6.8%	4.2%	2.6%
Energy	7.7%	6.0%	1.7%
Utilities	2.5%	1.7%	0.7%
Information Technology	0.0%	0.8%	-0.8%
Health Care	3.4%	4.7%	-1.3%
Materials	15.0%	16.9%	-2.0%
Property	4.6%	7.1%	-2.5%
Consumer Staples	4.5%	8.2%	-3.6%
Financials (ex-Property)	33.1%	38.0%	-5.0%
Total	100%	100%	

Month in Review

- The S&P/ASX 300 accumulation index added 0.65% for May, with Energy and Healthcare the top performing sectors.
- The Ralton High Yield Model Portfolio returned 1.33%, outperforming the benchmark index by 0.68%.
- At a sector level, stock selection within both Materials and Financials added value to the portfolio. There were few significant underperformers, however our healthcare exposures detracted modestly from overall performance.

Portfolio Commentary

Month Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Village Roadshow Ltd	Overweight	Chandler Macleod Group	Overweight
Amcor Ltd	Overweight	Sky Network Television	Overweight
Duet Group	Overweight	Sonic Healthcare	Overweight

Positive Contribution

Village Roadshow (VRL, +17.1%) was the portfolio's top performer for the month. Rolling-year to the end of May the share price is now up 61%. The strength in the share price is, in our view, representative of the quality of the assets that VRL own, namely cinemas, film distribution rights, and entertainment parks, mostly in Australia but with several modest sized operations elsewhere. Historical issues around debt levels and corporate governance had kept VRL out of our investment universe, however, substantial improvements on this front brought the company onto our investment radar. VRL successfully built and opened a large scale water park in western Sydney last summer, tapping into a market ripe for an entertainment product of this type and applying one of its successful concepts in a new market. Investment team members have been waiting to try it out, but the crowds have kept them away from the slide so far!

Amcor Limited (AMC, +3.1%) added value to the portfolio, performing relatively strongly as an analysts tour of Asian operations focused attention on the company's prospects in emerging markets. Early in May the company announced the acquisition of Bella Prima Packaging, an Indonesian 'flexible packaging' business, for $A27m. Later in the month, AMC hosted its Asian investor tour, focusing on Indonesia and India. The acquisition and the tour together highlighted the importance of the Asian region to the Amcor group. As emerging market populations increase their median income, the demand from consumers for Western-style products and packaging typically accelerates. Amcor has substantial intellectual property in the packaging space which is demanded by middle-class consumers, and is a supplier of choice to many of the world's leading global consumer brands (e.g. Unilever and Proctor & Gamble) who themselves are seeking to grow their operations in emerging markets. AMC achieve some 30% of their sales in emerging markets and its ability to continue to grow revenue strongly from these markets, in spite of individual periodic market disruptions, is a core part of our investment thesis for the company.

Duet Energy (DUE, +11.1%) also added to the portfolio's return as bond yields continued to decline and the market speculated about potential merger and acquisition activity. Specifically, Spark Infrastructure group (SKI) acquired a 14.1% interest in DUE during May at an average entry price of $2.16. DUE own a series of investments, including majority ownership in the Dampier to Bunbury pipeline, the premier gas pipeline in Western Australia. In isolation, the rationale behind SKI taking a minority stake in DUE is not clear, however, it is clear that they are positioning themselves for any future corporate activity in the sector.

Negative Contribution

Recruitment services company Chandler Macleod (CMG, -18.1%) was the largest detractor from portfolio performance. The company issued a profit downgrade citing a softening of business confidence in recent months, which related to the persistently high Australian dollar and the potential negative impact of the May budget. Demand for CMG's blue collar workers has been improving, while results in CMG's physiotherapy placement service Vivir and hotel outsourcing business have been in line with company forecasts. However, demand for white collar workers has been below expectations. Overall the mix of outcomes will see CMG fall short of the expected level of profit growth for the financial year. Although disappointed, we expect that CMG will continue to grow profits, particularly through internal initiatives, provided that the overall economic environment does not deteriorate markedly. We will continue to monitor the economic environment closely as risks are currently skewed to the downside.

The fall in consumer sentiment appeared to weigh on Sky City Entertainment (SKC, -7.7%), whose focus is casino and entertainment precincts in both New Zealand and Australia. However, a recent analyst presentation on the upgrade to SKC's Adelaide casino contained positive news for the stock, noting increased foot traffic to the casino following the recent upgrade to the Adelaide Oval, Adelaide's premier sporting facility.

Despite rising for the month, Sonic Healthcare (SHL, +0.06%), underperformed the market and detracted from portfolio performance for the month. Measures announced in the federal budget, specifically the implementation of a 'co-payment' for medical services for GP's, pathology and radiology proved an overhang for SHL. Although such initiatives were expected, the detail was perhaps worse than forecast for the sector, and may lead to a decrease in service volumes that may not offset the increase in take home revenue to the service provider. At this stage the legislation is still subject to senate approval and may be amended in some way in order to gain passage. Our view is that provided demand for services do not fall materially, the impact of lower volumes but higher fees is unlikely to materially impact SHL's profits, particularly given SHL's revenues are mostly derived from offshore and non-GP referrals.

Portfolio Adjustments

During the Month we...

SOLD:

BOUGHT: Transurban Group (TCL)

Purchases

Transurban Group (TCL) was a new addition to the portfolio in May. TCL own a portfolio of high quality toll roads, concentrated across the eastern seaboard of Australia. The assets are high quality, largely intra-urban roads with strong volume growth from demographic changes and essentially mandated annual fee rises for road users across the life of the asset or concession period. The combination of GDP driven volume increase in traffic load plus annual price hikes gives strong ongoing growth in free cash flow for TCL and hence growth in dividends to its investors. The recent acquisition of the Queensland-based QML road network appears to be a solid, long-term investment. The capital raising associated with the QML acquisition provided a depressed price which we used to acquire the position.

We increased our holding in Recall Holdings (REC), noting the strong start the company has made in terms of acquisitions since the demerger from Brambles at the end of 2013. The company recently acquired US-based CitiStorage for $47.2m. Given their clean balance sheet and a quite fragmented industry, REC are well placed to grow by acquisition, building on the current storage footprint and the high degree of recurring revenue and free cash flow that the business delivers. We also recently attended a meeting with management where they provided far more insight about the moat which exists around the storage business (it is a very sticky business). As counterintuitive as it might seem in this digital age, the demand for long-term hard storage is growing due to regulatory requirements and litigation risks.

Disposals

There were no outright sales in May from the High Yield Model Portfolio, however we reduced our holding in Australia and New Zealand Banking Group (ANZ) following a strong run in the share price. ANZ's half year profit results were in line with market forecasts, and most individual metrics such as loan losses, loan growth and cost growth delivered as expected. Banks currently offer an attractive yield relative to cash, but at some point the bad and doubtful debt charge will start to rise and this will pressure sector earnings. The timing for this change of direction is uncertain.

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

Stephen Sedgman Chairman OC Funds Risk Mgt Committee

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