Monthly Report
November 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	-1.39	0.03	8.94	19.03	10.18	7.11
Income Return	0.57	1.20	4.86	5.12	5.02	5.09
Growth Return	-1.96	-1.17	4.08	13.91	5.15	2.02
S&P/ASX 300 Acc. Index	-3.24	-4.53	4.04	13.38	6.82	3.52
Difference	**1.85**	**4.56**	**4.90**	**5.65**	**3.35**	**3.59**

**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	BHP Billiton Limited	BHP
5	National Australia Bank Limited	NAB
6	Amcor Limited	AMC
7	Westpac Banking Corporation	WBC
8	Incitec Pivot Limited	IPL
9	Recall Holdings Limited	REC
10	Sonic Healthcare Limited	SHL

GICS Sector	Ralton	Index	+/-
Industrials	15.7%	7.2%	8.5%
Consumer Discretionary	8.6%	4.3%	4.4%
Materials	18.9%	14.9%	4.0%
Telecommunication Services	9.0%	5.9%	3.1%
Utilities	1.9%	1.8%	0.1%
Energy	5.1%	5.1%	0.0%
Health Care	5.4%	5.8%	-0.4%
Information Technology	0.0%	1.0%	-1.0%
Consumer Staples	2.7%	7.6%	-4.8%
Property	2.8%	7.8%	-5.0%
Financials (ex-Property)	29.9%	38.7%	-8.8%
Total	100%	100%	

Month in Review

- The S&P/ASX 300 Accumulation Index reversed part of last month's gains, falling 3.24% in November, with Energy and Consumer Staples the worst performing sectors
- The Ralton High Yield Model Portfolio returned -1.39% for the month, outperforming the benchmark by 1.85%
- The portfolio's overweight position in the Industrials sector was the key contributor to portfolio outperformance, offsetting declines in the Energy sector

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Recall Holdings	Overweight	Mermaid Marine	Overweight
Amcor Limited	Overweight	Origin Energy	Overweight
Skycity Entertainment	Overweight	Sonic Healthcare	Overweight

Positive Contributors

Recall Holdings (REC, +9.9%) was the portfolio's top contributor for the month. At the company's AGM, management highlighted stable operating conditions in end markets and the continued execution of strategic initiatives. REC recently completed both the purchase of Business Records Management, a significant bolt-on acquisition in the United States market, and the previously announced transaction to sell the German SDS (Secure Destruction) operations. Also of note, the REC board is now formally investigating the benefits of converting to a REIT (Real Estate investment Trust); industry leader Iron Mountain (IRM) completed their conversion to REIT in the US earlier this year. REIT conversion is a complex, lengthy process and would incur considerable transaction costs, however it may well add value for REC investors on the basis of an improved tax status.

Amcor Limited (AMC, +3.8%), one of the portfolio's largest and long held positions, also boosted returns. The company's AGM highlighted the attractiveness of the Amcor investment as steady growth in western markets is well supported by growth in the company's emerging market operations. It is worth noting that Amcor's emerging market exposure is well diversified, with operations in nearly 30 countries across the three key regions of Asia, Latin America and Eastern Europe. This diversity limits the profit impact in any given period of political, weather, or currency fluctuations destabilising any particular emerging market. We also noted management's positive tone at the AGM in relation to potential acquisitions. Given AMC's excellent acquisition track record under CEO MacKenzie, we are comfortable that any significant transaction will meet the company's return hurdles.

Share price momentum from last month's positive trading update at the Sky City Entertainment (SKC, +5.5%) AGM continued into November. In broad terms, SKC are mid-way through a series of refurbishments at each of their key properties in Adelaide and Auckland. The refurbishments include upgrades to the gaming facilities, new restaurants, car parks and broader entertainment precincts. In Auckland, an additional 300-bed hotel will be built to complement the current facilities. Revenue trends reported at the AGM were positive, particularly for the Auckland precinct. Following the positive AGM update and increased confidence in execution of the capital projects, we elected to increase our holding in SKC in mid October.

Underperformers

The reluctance of global oil cartel OPEC to cut production saw the oil price fall 18% during November. This in turn impacted our Energy stocks, with Mermaid Marine (MRM, -19%) and Origin Energy (ORG, -14.2%) the two largest detractors from portfolio performance.

One can speculate as to the political or other motivations of OPEC - ISIS and countries such as Russia for example are heavily dependent on oil profits - however it is clear that OPEC wants others, not themselves, to cut production and thereby restore balance to the market. US shale producers, who have been the cause of the increased supply, are the likely targets. With 50% of US shale oil production having 'cash' costs above US$65, we would expect a rational supply response from this market, whose owners are of course profit, not politically, driven. However, until supply is reduced we believe that the oil price will remain volatile and that a trading range from say US$60 to US$80 for Brent is likely in the medium term.

For energy stocks, the lower oil price leads to lower profits and cash returns. We chose to sell our holding in WA-based energy service provider, Mermaid Marine (MRM). The rapid fall in the oil price and the volatility and lower trading range for oil prices we expect in the near term will see oil companies reconsider both their production volumes and capital projects. On the latter, we expect a significant 'knee-jerk' response to the falling oil price, which will in turn reduce the demand for service providers across the whole energy sector. Prices and profit margins will be under pressure and we could well see companies such as MRM either sell assets or raise equity to shore up their balance sheets. We will continue to monitor the stock however as we have a favourable view of MRM's strategy of diversifying away from a pure Australian focus and their recent Jaya transaction.

Global pathology player Sonic Healthcare (SHL, -6.6%) retraced last month's gains following an earnings downgrade at its AGM in November. The company reduced financial year 2015 profit guidance from 5% EBITDA growth in constant currency to a range of 2-4% EBITDA growth. Management cited weaker volumes in their Australian pathology business following the Government's proposal of patient co-payments for GP and pathology visits. Even though the measure has not passed the Parliament, it seems patients were sufficiently confused and distracted to defer attendance. Importantly, SHL believes that pathology volumes have been returning to normal over recent weeks, although the lost volume will not be recouped this financial year. Pleasingly for investors, SHL's German, Swiss and US operations are largely meeting or exceeding company forecasts. Further, SHL continues to advance discussions for a large regional contract in Edmonton, Canada - as we discussed last month, SHL are the preferred provider for this contract, which should deliver an incremental $C200m revenues to the group.

Portfolio Adjustments

During the Month we...

SOLD: Automotive Holdings (AHE), Blackmores Limited (BKL), Westfarmers Ltd (WES)

BOUGHT: Pact Group Holdings Ltd (PGH)

Portfolio Additions & Material Adjustments

We added an initial position in the recently listed Pact Group (PGH). Pact are a packaging and manufacturing company with multiple manufacturing plants across Australia, New Zealand and Asia, producing a broad range of simple and specialised packaging products for clients who are largely in the food industry. PGH has dominant market share in their industry segments, where typically there are few competitors of scale and concentrated market share. If you look in your fridge you are highly likely to find a milk, yoghurt or orange juice package manufactured by PGH. Pact had a strong track record of growth by acquisition when in private hands, and we would expect this to continue. When PGH first listed on the stock exchange in late 2013 it was, in our opinion, carrying too much debt, however those debt levels have reduced over subsequent reporting periods, making the stock an attractive investment.

Portfolio Disposals & Material Adjustments

We sold three stocks outright from the portfolio during the month, namely Automotive Holdings (AHE), Blackmores (BKL), and Wesfarmers (WES), largely reflecting our view of each stock's fair value, along with a decision to reduce our overall exposure to consumer sensitive stocks.

Starting with Automotive Holdings (AHE), we note the modest declines in new passenger car sales over recent months. At this stage, the decline is being lead by government and fleet buyers, although we feel that the consumer may well begin to feel the pinch in coming months. AHE has a geographic bias to WA, which given the pressures on this resource-focused state may continue to struggle. At or near $4, we felt that these headwinds were not reflected in the share price. Going forward, we would highlight that the company is targeting an improvement in portfolio returns from their cold storage division. Thus far, AHE has lacked scale and has faced integration headwinds. Progress on this front would certainly see us reconsider an investment in AHE, subject of course to price.

With vitamin manufacturer and distributor Blackmores (BKL), we had benefitted from a re-rating of the company in recent times as the industry seemed to have entered a more rational phase. Key competitor Swisse has reduced both its discounting and its blanket, high cost advertising, allowing for BKL and others to stablise their prices, margins and market share. BKL has and will continue to benefit from its efforts to grow distribution in Asia, however the current market valuation did not appear to reflect any risk that consumers might reduce their expenditure in what is actually a somewhat discretionary consumer purchase.

Finally with WES, the company was trading at what we considered a reasonably full valuation in the current market. WES has been successful in turning around the top line sales growth and margins at their key business, Coles supermarkets. The easy gains here have been made however and the outlook for this key division is moderating. As highlighted in recent market updates by Woolworths (WOW) and Metcash (MTS), the supermarket industry in Australia is becoming increasingly competitive. Discounters Aldi and (to a lesser extent) CostCo are gaining market share and the consumer is becoming far more cost conscious.

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

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