Ralton Smaller Companies

Quarterly Report March 2015

Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Ralton Smaller Companies 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 Smaller Companies SMA is to provide investors with long-term capital growth and some tax effective income from a concentrated portfolio of smaller capitalisation ASX listed shares. The Portfolio aims to deliver a return superior to that of the market over periods of five years or longer while at the same time seeking to minimise the risk of investment capital loss.

Key Portfolio Features	
Inception	1 February 2008
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Authorised Investments	ASX listed companies that are not included in the S&P/ASX 50 Index
Number of Stocks	25-40
Cash Allocation	0% to 15%
Tracking Error	5% to 9% per annum
Investment Horizon	At least 5 years
Ratings	

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Smaller Companies	3.32	8.89	13.77	17.01	12.51	7.68
Income Return	1.04	1.17	3.19	3.81	3.77	3.89
Growth Return	2.28	7.72	10.57	13.19	8.74	3.79
S&P/ASX Small Ords Acc Index	-1.94	7.30	2.30	-1.72	-0.30	-2.49
Difference	**5.26**	**1.59**	**11.46**	**18.72**	**12.81**	**10.17**

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

The Portfolio is designed for investors who...

- Seek long term capital growth & some tax-effective income
- 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	Fisher & Paykel Healthcare Corporation	FPH
2	Sky Network Television Limited	SKT
3	Aristocrat Leisure Limited	ALL
4	Energy Developments Limited	ENE
5	Macquarie Atlas Roads Limited	MQA
6	News Corporation	NWS
7	Blackmores Limited	BKL
8	Super Retail Group Limited	SUL
9	Skycity Entertainment Group Limited	SKC
10	Transpacific Industries Group Limited	TPI

GICS Sector	Ralton	Index	+/-
Consumer Discretionary	39.3%	24.8%	14.5%
Health Care	13.3%	8.5%	4.8%
Utilities	4.3%	0.7%	3.6%
Consumer Staples	5.7%	3.0%	2.8%
Energy	5.0%	5.0%	0.0%
Telecommunication Services	3.5%	4.9%	-1.4%
Industrials	13.7%	15.7%	-2.0%
Financials (ex-Property)	5.1%	7.1%	-2.1%
Information Technology	2.1%	5.2%	-3.1%
Materials	8.0%	13.6%	-5.6%
Property	0.0%	11.5%	-11.5%
Total	100.0%	100.0%	

Quarter in Review

Performance Summary

- The S&P/ASX Small Ordinaries Accumulation Index had a strong start to 2015, adding 7.30% for the March quarter, with Consumer Discretionary and Telecommunications the top contributing sectors

- The Ralton Smaller Companies Portfolio made a solid gain of 8.89%, outperforming the benchmark by 1.59%

- The portfolio's overweight position in Utilities and Consumer Staples added to portfolio returns, offset to some degree by our significant cash holdings

Portfolio Commentary

Quarterly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Blackmores Limited	Overweight	Austbrokers Holdings Ltd	Overweight
Energy Developments	Overweight	Cash Converters International	Overweight
Nufarm Ltd	Overweight	Ardent Leisure	Overweight

Positive Contributors

Vitamin manufacturer and distributor Blackmores Limited (BKL, +55.0%) was the portfolio's top contributor for the quarter, boosted by a profit upgrade in January. Specifically, BKL has delivered a 22% rise in sales and 50% increase in profit for the first half of the financial year, largely driven by strong profit growth in the Australian region. These results vindicate our view that industry dynamics for the vitamin segment in Australia have significantly stabilised during the last 12 months, in part due to less discounting and promotional spending by competitor, Swisse. BKL have a small, but growing, presence in Asia, and we believe that over time several of those markets, including Korea, Thailand, Singapore and Malaysia, could become material to the BKL group. At present, revenue growth in Asia is being matched by cost growth and one-off items, and hence it is yet to materially add to the profit growth of the group.

Energy Developments' (ENE, +33.2%) half-year profit results were strong as the company increased their profit guidance and confirmed dividend forecasts for the full (financial) year. ENE provides electricity generation in many remote sites across Australian and in the UK. With Australian miners seeking cost savings, ENE are seeing many opportunities to expand their service offering, which of course bodes well for future growth. These opportunities, together with the reasonably predictable cash flows that will be delivered from the current long-life, contracted utility assets, supports our investment in ENE.

Global crop protection specialist Nufarm Ltd (NUF, +40.3%) continued its recent business and share price momentum in February. The major news flow during the quarter was the retirement of long-time managing director, Doug Rathbone. Simultaneously, the company announced a targeted $100m+ cost reduction program across their global operations. At this stage NUF have only released concrete details relating to around $40m of these cost savings, specifically relating to the Australasian and European operations. The rest of the cost savings are yet to be detailed by NUF. Such an approach is reasonable given the CEO transition.

Nufarm has made considerable progress in restructuring and refocusing the business following a period of time when profit forecasts were missed, debt rose, and oversupply of one of NUF's key products, glyphosate, rattled investors and the share price in turn. The Nufarm of today is a far more diversified business, by product, region and market segment. The business has a strong product offering across a range of crops and crop protection chemicals. Although Rathbone has long been a passionate, energetic leader and a key driver of NUF's global expansion, his tenure is certainly heavily tied to previous profit downgrades. On this basis, his exit, with the business now in a much improved shape, would be seen by many investors as a reason to revisit NUF; hence the share price movement in our view.

Underperformers

Austbrokers Holdings (AUB, -14.5%) weakened after a profit downgrade in January and was the key negative contributor to the portfolio for the period. AUB is focused on insurance broking and has ownership stakes (typically majority stakes) in a network of insurance brokers across Australia. These brokers offer a range of insurance services to clients, largely SME type businesses. AUB make profits from the underlying broker businesses, but also profit from offering a range of services to the broker businesses. January's profit downgrade was driven by a rapid fall in insurance premiums across the final quarter of calendar year 2014, which of course flows through to AUB's commissions and profits. AUB has delivered very steady profit growth since listing, driven by organic growth in the commissions generated from it's network, augmented by ongoing consolidation efforts, adding brokers to the network. At this stage, we have reduced our position in AUB, although we are seeking to ascertain the future directionof premium trends in the market and how this will impact AUB before making a decision either way on the balance of the investment.

Cash Converters (CCV, -10.5%) reported solid half-year profit results from their Australian operations in February, however losses on the UK personal loan portfolio appear to have weighed on the CCV share price. The UK pawnbroking industry has been undergoing regulatory change similar to that which Australia experienced several years back. This has seen the industry shrink and bad debts rise, triggering CCV to report a write-down on most of the outstanding loan book. For CCV the UK is only a small contributor, however the CEO is committed to turning around the UK business this year or exiting short-term lending entirely. With the UK market shrinking, CCV's position has likely improved and hence we suspect a turnaround has merit. However for the time being the market viewed the reduced group profit as very much a 'barnacle on the boat.'

Ardent Leisure (AAD, -23.2%) surprised the market with a profit shortfall at their gyms for the first half of financial year 2014. AAD own a series of 75 clubs across Australia, mostly under the Goodlife banner, and these account for some 25% of company profits. AAD had experimented with a shorter gym membership offering, attempting to compete with low-cost 24-hour offerings in various regions. The experiment appears to have backfired with AAD reporting a rise in member churn from the shorter tenure offering. This in turn lowered profits from AAD's existing gym network and lead to a change in strategy. AAD will now move a series of their gyms toward a 24 hour offering, increasing access times for members, but with a lower staff and service offering outside regular hours.

Subsequent to the half-year results, the AAD board led by Chairman Neil Balnaves removed CEO Greg Shaw and replaced him with current board member, Deborah Thomas. Shaw was well respected by investors and had been group CEO since before the IPO in 2001. The market immediately focused on Thomas' lack of operational experience versus Shaw's. This series of events has not been well received by the market, and several large shareholders now appear set to hold an EGM and seek Shaw's reinstatement and possibly a spill of the board. Acknowledging the uncertainty and short term distraction that this creates, we still see AAD as holding a quality series of assets and would highlight the recent strong results and outlook for the group's US-based Main Event offering - the key attraction for our investment. So to summarise, at this stage, we are taking a watch and see approach. Despite the board and management ructions, the company holds strong assets and we expect that value to be realised over time.

Portfolio Adjustments

During the Quarter we...

SOLD: Recall Holdings Limited (REC), Orora Ltd (ORA)

BOUGHT: Navitas Limited (NVT)

Portfolio Additions & Material Adjustments

Navitas Limited (NVT) was the only new stock added to the portfolio during the quarter. NVT is an education service provider whose core business is providing 'pathway' courses for students ahead of university entrance. NVT have a global network of 'colleges' across four continents. These 'colleges' provide NVT courses, typically on campus at a 'host' university. With a growing presence in the US, established over recent years, and improving performance from NVT's technology-focused SAE division, we believe the outlook for NVT is favourable. The company's first-half profit results underwhelmed the market due to one-off costs in the smaller SAE division in the United States and we saw the resulting share price weakness as an opportunity to buy the stock.

Portfolio Disposals & Material Adjustments

During the quarter we sold out entirely from both Recall Holdings (REC) and Orora Limited (ORA).

Since demerging from Brambles in late 2013, REC had been a very strong performer. Confirming our investment thesis, management had completed a series of strategic steps, selectively acquiring bolt-on businesses, undertaking a thorough optimisation and operational overhaul and taking steps to move with customers into the digital age. When the stock was buoyed by a takeover bid from US company Iron Mountain, we saw the share price reach what we considered fair value and sold our holding. IRM may well increase their bid, however we view the upside as modest versus the potential downside in the near term if IRM abandon the takeover.

We also sold the balance of our holding in Orora (ORA) in March. Like Recall, ORA was formed via demerger from it's parent (Amcor) in late 2013, was added to the portfolio and was one of the strong contributors to our performance across 2014. Management has done an excellent job since the demerger, delivering on what we largely saw as a self-help initiatives. ORA continues to meet cost saving targets, the bulk of which are flowing from the ongoing ramp-up to full production of the Botany paper mill (B9) in Sydney. The US side of the business makes up 30% of revenues and has received considerably more focus under ORA management than during AMC's ownership. The benefits of this have been improved sales growth and also margin improvement from manufacturing initiatives. We do however believe that these benefits are largely priced in now and hence we are comfortable taking profits.

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)

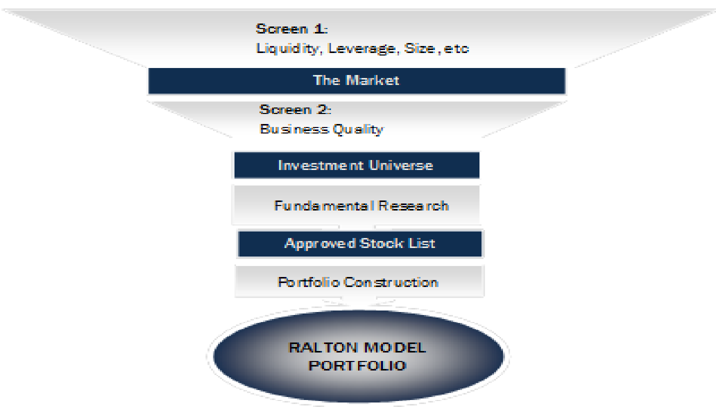
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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 partnered with Copia Investment Partners, an administration and distribution specialist providing a range of tailored services to each of our leading boutique investment partners.

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*
Head of Australian Equities, 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 24 years, including the past 9 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

Roger Walling is responsible for stock coverage of several industry sectors and assists with the portfolio management process. He has over 12 years of direct funds management experience, including the past 8 years managing the Ralton portfolios. Previous to Ralton, Roger was a shareholder and employee of Cinnabar Equities, a Global Healthcare Fund. In his role as a Senior Analyst, he had sub-sector and stock investment decision responsibility. Prior to his career in financial markets, Roger practiced as an Optometrist.

For Further Information

Financial advisers seeking additional information can contact Ralton Adviser Services at:

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