RALTON ASSET MANAGEMENT

# Ralton Smaller Companies

# Monthly Report April 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** | MORNINGSTAR ★★★★ Approved Lonsec Research |

**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.

## Performance

| Return % | 1m | 3m | 1yr | 3yrs | 5yrs | Incept* |
|---|---|---|---|---|---|---|
| **Ralton Smaller Companies** | -0.37 | 6.98 | 13.44 | 16.60 | 12.07 | 7.54 |
| *Income Return* | 0.06 | 1.22 | 3.11 | 3.61 | 3.69 | 3.85 |
| *Growth Return* | -0.42 | 5.76 | 10.34 | 12.99 | 8.37 | 3.68 |
| S&P/ASX Small Ords Acc Index | 1.66 | 8.10 | 5.31 | -0.87 | 0.02 | -2.24 |
| **Difference** | **-2.03** | **-1.12** | **8.14** | **17.47** | **12.04** | **9.78** |

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

## Portfolio Structure

| No. | Company Name | ASX Code |
|---|---|---|
| 1 | Fisher & Paykel Healthcare Corporation | FPH |
| 2 | Sky Network Television Limited | SKT |
| 3 | Energy Developments Limited | ENE |
| 4 | Aristocrat Leisure Limited | ALL |
| 5 | Macquarie Atlas Roads Limited | MQA |
| 6 | Slater & Gordon Limited | SGH |
| 7 | News Corporation | NWS |
| 8 | Pact Group Holdings Limited | PGH |
| 9 | Super Retail Group Limited | SUL |
| 10 | Blackmores Limited | BKL |

| GICS Sector | Ralton | Index | +/- |
|---|---|---|---|
| Consumer Discretionary | 40.3% | 25.3% | 15.1% |
| Health Care | 13.1% | 8.0% | 5.0% |
| Utilities | 4.3% | 0.8% | 3.6% |
| Consumer Staples | 6.2% | 2.9% | 3.3% |
| Energy | 5.5% | 5.8% | -0.3% |
| Industrials | 13.7% | 15.4% | -1.7% |
| Telecommunication Services | 2.3% | 4.9% | -2.6% |
| Information Technology | 2.1% | 5.1% | -2.9% |
| Financials (ex-Property) | 2.9% | 6.8% | -3.9% |
| Materials | 9.6% | 13.8% | -4.2% |
| Property | 0.0% | 11.3% | -11.3% |
| Total | 100.0% | 100.0% | |

# Month in Review

## Performance Summary

- The S&P/ASX Small Ordinaries Accumulation Index had a strong month in April, adding 1.66%, boosted by strong performance from both the Energy and Materials sectors
- The Ralton Smaller Companies Portfolio fell 0.37%, underperforming the benchmark by 2.03%
- The portfolio's underweight position in Materials detracted from relative performance, while our stock selection in both Telecommunications and Consumer Staples added to returns

## Portfolio Commentary

# Monthly Performance Attribution

| Top Contributors | Positioning | Key Detractors | Positioning |
|---|---|---|---|
| Blackmores Limited | Overweight | Greencross Limited | Overweight |
| Nufarm Ltd | Overweight | Ardent Leisure | Overweight |
| AWE Limited | Overweight | News Corp. | Overweight |

### Positive Contributors

Vitamin manufacturer and distributor Blackmores Limited (BKL, +16.6%) posted solid third-quarter profit results, the update confirming continuing strong sales and profit growth. Sales for the company's core Australian vitamins business and the practitioner-driven BioCeuticals brand were both very strong. Sales in Asia, a small part of the business at present, were solid, although mixed throughout the region. Going forward, Asia's middle class will no doubt have an appetite for BKL's products, and although the market is likely to be highly competitive and involve differing dynamics, we note that BKL have been building their presence in several key Asian countries for many years, and hence should be well placed to benefit from this demand.

Nufarm (NUF, +9.6%) moved higher in April, having posted solid profit results for the first half of their financial year. As highlighted previously, NUF has made considerable progress in restructuring and refocusing the business along both geographic and product lines and this was evident in the first half result. NUF recently announced the appointment of current COO Greg Hunt as incoming CEO. Mr Hunt has a strong pedigree in the agricultural sector and will clearly be the driving force behind the delivery of the targeted $100m net savings that NUF have highlighted. Delivery of such cost savings would be highly material to the company and our recent discussions with management have somewhat increased our confidence that these can be both achieved and, more importantly, retained.

Mid-cap oil and gas producer AWE Limited (AWE, +19.2%) was boosted by the rising oil price in April, together with solid drilling results from their Irwin 1 drill well in the Perth Basin, WA. AWE has ownership stakes in several producing assets, with growth in future production likely to come from their development interests in Ande Ande Lamut (Indonesia), the Perth Basin (Australia) and the Lengo gas field (Indonesia). Each asset is at varying stages of development, with recent drill results from Perth Basin confirming the highly prospective nature of this asset in particular.

### Underperformers

Greencross (GXL, -16.8%) whose two core businesses are pet care retailing and veterinary services, weighed on performance for the portfolio. Despite the lack of news flow in April the market appeared to be anticipating a revision to profit guidance. In early May, Greencross confirmed that trading conditions had been difficult and reduced their profit guidance for the full year, although the scale of the profit revision was modest. GXL cited issues around weather on the Eastern Seaboard impacting their newly minted supply chain and logistics strategy. Our investment in GXL is centered on the strong store rollout potential, plus our view of the strength of demand and people's willingness to spend on their pets.

Ardent Leisure's (AAD, -11.4%) recent share price woes continued into April. As highlighted last month, following the half-year results in February and the disappointing results from the health clubs or gyms business, the AAD board, led by Neil Balnaves, removed CEO Greg Shaw and replaced him with current board member, Deborah Thomas. Shaw was well respected by the 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 and the share price has continued to be under pressure. Despite the board and management ructions, the company holds strong assets and we expect that value to be realised over time. Supportive of this view, the company's third quarter trading update, announced in early May, highlighted ongoing strong results from the US Main Event business and reasonable results across the other divisions. Commentary suggested that the health business has somewhat stabilised and that new initiatives around transforming gyms to a 24-hour format were gaining traction on key measures.

Finally, diversified media company, NewsCorp (NWS, -7.12%) impacted negatively on portfolio returns, although there was little news flow, so to speak. The move in the Australian dollar, gaining against the US dollar in April, certainly weighed on the stock, given that several of NWS' businesses operate offshore. NWS recently acquired a 15% stake in listed entity APN News and Media, which has a portfolio of radio stations and other media assets.

# Portfolio Adjustments

## During the Month we...

**SOLD:** Austbrokers Holdings Limited (AUB)

**BOUGHT:** G8 Education Limited (GEM)

### Portfolio Additions & Material Adjustments

We added childcare centre operator, G8 Education (GEM) back into the portfolio in April, having sold the stock some 12 months ago, on share price weakness. The weakness was driven in part by regulatory concerns - more specifically, potential for significant changes in government funding following from a Productivity Commission (PC) review ahead of the Federal Budget. The market was also concerned that GEM were paying too high a price to acquire childcare centres and questioned GEM's ability to fund these acquisitions through share issues while simultaneously maintaining their high dividend payout ratio. With the significant decline in the share price, comfort that the business operations were on track and, finally, having digested the PC draft and final report, we felt that the share price weakness was overdone and began to rebuild a position in the stock.

### Portfolio Disposals & Material Adjustments

During the quarter we sold the last of our holdings in Austbrokers Limited (AUB). In prior reports we have discussed concerns we had in regard to the premium cycle and likelihood of further falls in premiums and therein commissions by which AUB's broker network make profits. Having assessed this element in more detail, we were unconvinced that the outlook for premium cycles was positive and elected to sell our position. We still like the business and management and should our views on this key issue change, we will look to revisit AUB accordingly.

# 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)

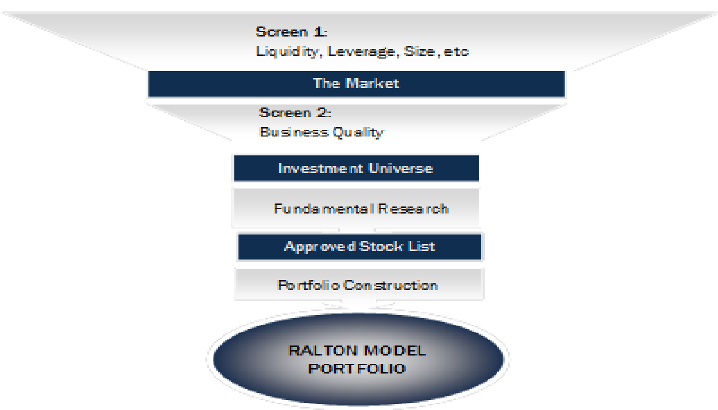
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

### 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 7 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 7 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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