Ralton Australian Shares

Quarterly Report June 2015

Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Ralton 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 Australian Shares SMA is to to provide investors with long-term capital growth and some tax effective income from a concentrated portfolio of Australian 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 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	3% to 6%
Investment Horizon	At least 5 years
Ratings	MORNINGSTAR ★★★★ Approved Lonsec Research

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Aust Shares	**-4.56**	**-5.42**	**14.10**	**19.98**	**12.47**	**7.20**
Income Return	*0.04*	*0.63*	*3.82*	*4.22*	*4.42*	*4.40*
Growth Return	*-4.59*	*-6.06*	*10.28*	*15.76*	*8.05*	*2.80*
S&P/ASX 300 Accum. Index	-5.32	-6.48	5.61	14.71	9.45	3.96
Difference	**0.76**	**1.06**	**8.49**	**5.26**	**3.01**	**3.24**

**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	National Australia Bank Limited	NAB
2	Commonwealth Bank of Australia	CBA
3	CSL Limited	CSL
4	Westpac Banking Corporation	WBC
5	ANZ Banking Group Limited	ANZ
6	BHP Billiton Limited	BHP
7	QBE Insurance Group Limited	QBE
8	Aristocrat Leisure Limited	ALL
9	Woolworths Limited	WOW
10	Amcor Limited	AMC

GICS Sector	Ralton	Index	+/-
Consumer Discretionary	14.8%	4.3%	10.5%
Health Care	11.0%	6.0%	5.0%
Materials	16.6%	14.8%	1.8%
Information Technology	2.0%	1.0%	1.0%
Energy	5.4%	5.1%	0.3%
Industrials	7.4%	7.2%	0.1%
Utilities	1.4%	2.0%	-0.6%
Consumer Staples	5.8%	6.5%	-0.7%
Financials (ex-Property)	33.6%	39.2%	-5.6%
Telecommunication Services	0.0%	5.9%	-5.9%
Property	1.9%	7.9%	-6.0%
Total	100.0%	100.0%	

Quarter in Review

Performance Summary

- The S&P/ASX 300 Accumulation Index fell heavily losing 6.48% for the June quarter, with Financials and Consumer Staples the key detractors. For the June financial year the index added 5.61%
- The Ralton Australian Shares Model Portfolio fell -4.52% for the quarter, outperforming the benchmark by 1.06%, and over the financial year added 14.1%, outperforming the benchmark by 8.49%
- For the quarter, the portfolio's overweight to Industrials added value as did our underweight position in Financials, principally banks.

Portfolio Commentary

Quarterly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
QBE Insurance	Overweight	ResMed Inc.	Overweight
Pact Group Holdings	Overweight	BlusScope Steel Ltd	Overweight
Asciano Limited	Overweight	Coca-Cola Amatil	Overweight

Positive Contributors

QBE Insurance (QBE, +4.8%) was the portfolio's top contributor for the quarter. In fact, the share price has risen strongly this calendar year after the company finally delivered a clean set of financial results in February and completed a major balance-sheet and business portfolio de-risking exercise. Although the turnaround has taken longer than we originally had hoped, QBE has now made major strides in improving the quality of its capital position and reducing the risk associated with its insurance book. The steps taken on the insurance book should serve to substantially reduce future earnings volatility. The company is most of the way through a major business transformation, moving many back-office functions from high cost operations in Sydney, London and New York to a company-owned operation in Manila. We are of the view QBE is again positioned to grow its core revenue and dividends.

Packaging and manufacturing specialist, Pact Group (PGH, +10.9%) finished the quarter in positive territory, boosted by the $80m acquisition of Jalco Group. Jalco, established in 1973 is a a contract manufacturing, packaging, and filling company focused on the non-food FMCG segment. Like PGH itself, Jalco has many top tier customers including Unilever, Avon, Colgate, Coles and more. We see the acquisition as complimentary to PGH, consistent with the overall growth strategy and appears to have been done on attractive financial terms. It appears there will be opportunity for PGH to improve the Jalco margins as they sit well below those of PGH.

Shares in Asciano Limited (AIO, +4.9%) also held up well in a tough quarter for the market. AIO recently commenced operations with their automated cranes at the Port Botany container terminal. The switchover to the new system has gone smoothly - always a positive when a company 'turns the key' after spending considerable capital on an upgrade. The automated facility is expected to both reduce costs per container lift and further increase the overall capacity of the terminal. This is particularly important given competition in the ports space has increased, with the arrival of global major Hutchison increasing capacity for the Australian East Coast port network and likely pressuring price across the industry. This marks the end of a major capital expenditure program for AIO, and we should see a substantial lift in the free cash flow and dividends from the company in the future. We believe this change should see a material re-rate of the stock in coming periods. (Note: post-quarter end, AIO has been subject to a takeover bid).

Underperformers

Medical technology company Resmed (RMD, -11.4%) lost ground during the quarter as a poor result in the third quarter sales release and a failed clinical trial weighed on the share price. The poor headline financial result for the third quarter should improve in coming periods as the company moves to address the issue with cost reductions. Also, RMD reported the results of a clinical trial failed as the breathing devices failed to show a benefit for patients with certain types of chronic heart failure. These are really sick people and it appears that the RMD treatment actually increased mortality (i.e. death rates) in a statistically significant way. Although disappointing, it is unlikely to impact RMD's current treatment of patients with various types of sleep apnea in the medium term. Although, in the short term, it may cause some disruption to sales as doctors reflect on the clinical trial data. As such, we did trim the holding whilst we wait to see the short term impact on quarterly sales from this development.

BlueScope Steel (BSL, -16.3%) weighed heavily on portfolio returns for the quarter. The main reason, in our view, for the share price fall appeared to be the ongoing weakness in the Asian price for hot rolled coil (HRC) steel. The exposure BSL has to this market segment comes from its production at Port Kembla (with part of the production being exported to Asia where it is being sold at a loss). The pressure on the HRC price comes predominantly from Chinese dumping of excess production (a function of its massive overcapacity in steel making). The Chinese production is not rationale as for much of the time they have not been covering their full input costs. We expect rationale behaviour to eventually return to this market. The rationale behaviour may include BSL closing down HRC production at Port Kembla. The business should then return to trading on the basis of its fundamentals. BSL has been restructured significantly in recent years with strong positions built in niche areas in both Asian and US markets along with the domestic ColourBond business. We view the stock as fundamentally cheap at these levels, but we expect it to take time to close the valuation gap.

Coca-Cola Amatil (CCL, -15.1%) gave back some recent gains and detracted from portfolio returns for the quarter. There was no clear reason for the underlying weakness. CCL is part way through a multi-year transformation and we expect there will be ups and downs along the way. We are attracted to the solid and sustainable dividend (given the strong free cash flow, near term decline in capex and the recapitalisation of its Indonesian operations) and the turnaround/re-positioning of the business, put in place by Managing Director, Alison Watkins.

Portfolio Adjustments

During the Quarter we...

SOLD: Brambles Ltd (BXB), South32 Ltd (S32), Sydney Airport Holdings Ltd (SYD), Transurban Group (TCL), Telstra Corp (TLS)

BOUGHT: Computershare Limited (CPU), Orora Ltd (ORA), Suncorp Group Ltd (SUN), Virtus Health Ltd (VRT), Woolworths Ltd (WOW)

Portfolio Additions

We added several stocks to the portfolio during the quarter. We added a position in Woolworths (WOW) as we felt that after the dramatic fall in the share price over the past 12 months, much of the risk from the group's well publicised problems were being factored in. Although, it may take some time for the benefits of the turnaround in many areas of the business to come through. In the interim a solid and sustainable yield should compensate us for being patient.

The key issues confronting WOW can be summarised as follows. Firstly, the core supermarkets business has lost faith with its customers. Its customers perceive that WOW has been gouging on price (even if the perception may be unfair). It takes many years for a group like WOW to end up in this position. Under Roger Corbett the group drove productivity improvements and reinvested the proceeds in lower everyday prices for customers. Under Michael Luscombe and then Grant O'Brien, the group focused on expanding margins to benefit shareholders at the expense of customers. The return of Coles as a touch competitor and the rise of Aldi has meant this strategy no longer works.

WOW is now reinvesting in price to win back customers. This will not be an easy process, however, we are of the view the group has admitted many of its mistakes in the supermarkets division and is on the long slow path of winning back customer trust.

Secondly, WOW made a botched attempt at entering the big-box hardware business through Masters to compete with Bunnings. This has sucked up a lot of the group's capital which otherwise could have been invested in refurbishing the supermarkets. However, a new strategy has now been put into place under a seasoned industry executive, Matt Tyson. The plans he has laid out sound credible. Only time will tell if he can fix the business and get it to achieve its targeted level of return. However, in our view, WOW will not be making losses of the current scale from the existing business in 3-years' time. It will either be turned around or divested. Either way, it is going to be a positive for the group on a 3-year view.

In summary, with a solid and sustainable dividend yield and a clear strategy in place to address the operating issues across the group, we felt that the valuation was sufficiently attractive to start buying. Like most turnarounds, we do not expect improvements to occur in a 'straight line', however, we do have confidence that it can be achieved with time.

We also purchased a position in Computershare (CPU) during May. CPU has a strong position in company share registries and a myriad of other processing type businesses. Until recently, CPU had grown strongly via acquisition; however this has slowed in recent years. We have purchased a position in the portfolio with a view that the stock offers reasonable value at these levels. CPU is focused on business simplification and offers upside to any movement in global interest rates (given the large cash balances it holds on behalf of clients).

A pullback in the share price of Orora (ORA) led us to add it back into the portfolio. As a refresher, Orora is a largely Australian-oriented packaging business, focused on bottles, cans and paper/fibre packaging. The US side of the business makes up 30% of revenues, but does provide for growth opportunities as that market place is more fragmented than Australia. Under Amcor, the company spent millions of dollars on plant closures and new capital expenditure, including the Botany paper mill (B9) in Sydney. Since demerging from Amcor in late 2013, ORA's management have successfully delivered on cost savings that relate to B9 and other self-help driven cost initiatives, together with driving a significant improvement in operating margins in the US. Despite low organic growth, we continue to expect ORA to deliver solid profit and dividend growth.

We added a small position in Virtus Health (VRT) late in the quarter after a pull-back in the share price. Virtus is the leading provider of in vitro fertilisation (IVF) services in Australia, with clinics in each of the major Eastern states. The clinics are top quality providers, well established and operate in a high barrier to entry sector of the healthcare industry. Demand for services has been very consistent over the last 15 to 20 years. Although in tougher economic times, demand has tapered somewhat. That is, people are tending toward less children! We also like the early steps the company is making to corporatise the sector in Ireland and beyond. This should provide a range of attractive growth opportunities in years to come.

We also acquired a small position in Suncorp (SUN) after its share price pull-back during the quarter. After the recent share price fall the stock offers an attractive yield and a moderate growth profile. The key opportunity for SUN comes from its banking operations if the competitive landscape for mortgages is levelled by the major banks being forced to hold capital more in line with SUN. This is a change most in the industry expect to happen. This should provide the group the opportunity to expand its interest margins and/or grow its book more aggressively. Its insurance operations remain under pressure as margins ease from very strong levels, but productivity improvements should provide some protection to overall earnings.

Finally, we also increased our position in National Australia Bank (NAB) during the quarter via participation in its rights issue and the acquisition of additional stock. We have finally become positive on NAB relative to the other major banks as it finally has a CEO and CFO who are addressing some of the key issues the group has faced for many years (both legacy and cultural issues). By addressing these internal issues, in our view, NAB should be able to drive its business better for shareholders, despite the issues facing the sector more broadly.

Portfolio Disposals

We exited several stocks during the quarter with a large part of the turnover reflecting a repositioning of the portfolio as we took profits in a number of stocks which have benefited from the yield theme over the past few years. The disposal of Sydney Airport (SYD), Transurban Group (TCL) and Telstra Corporation (TLS) does not suggest these are not great businesses. Rather, there were three factors driving the disposals:

a) the valuations have become stretched on most metrics for an extended period (largely driven by the obsessive hunt for yield in the market)

b) global bond yields have started to edge higher and this should continue as the US begins to raise rates later in the year; and

c) the market had thrown up some other attractive opportunities for us (something which has been lacking for some time).

We disposed of a small position in South 32 (S32) which we received as a result of the demerger of the company from BHP. S32's assets include mining and upstream processing facilities across several commodities including aluminum, thermal coal, manganese and nickel. The assets are non-core to BHP, though represent reasonable quality on a global scale. At this stage, we saw no compelling reason to hold the stock and with the share price trading higher upon listing, we elected to sell the position.

Finally, we disposed of BXB as the stock had reached what we believe was fair value in the current climate and given the other reinvestment opportunities we had available. Whilst management have done a good job of generating growth in a very tough economic environment over the past few years, we see few signs of the type of economic upswing in any of its key markets which are going to drive earnings growth from here (i.e. volume growth and pricing power in its core business are not as strong as it has been in past cycles).

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)

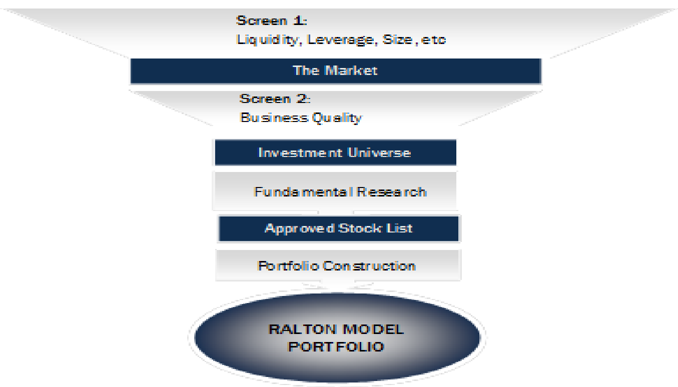
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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:

Name: John Clothier
Phone: 02 8216 0782
Mobile: 0408 488 549
Email: jclothier@copiapartners.com.au