Ralton Smaller Companies

Quarterly Report
June 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

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Smaller Companies	**-6.13**	**-4.13**	**8.93**	**17.85**	**13.83**	**6.81**
Income Return	*0.16*	*0.31*	*3.09*	*3.60*	*3.73*	*3.80*
Growth Return	*-6.29*	*-4.43*	*5.84*	*14.25*	*10.10*	*3.01*
S&P/ASX Small Ords Acc Index	-7.77	-4.04	0.44	2.46	1.35	-2.95
Difference	**1.64**	**-0.09**	**8.49**	**15.39**	**12.48**	**9.75**

**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	Super Retail Group Limited	SUL
2	Sky Network Television Limited	SKT
3	Pact Group Holdings Limited	PGH
4	Ardent Leisure Group	AAD
5	Aristocrat Leisure Limited	ALL
6	Macquarie Atlas Roads Limited	MQA
7	Fisher & Paykel Healthcare Corporation	FPH
8	Energy Developments Limited	ENE
9	Fletcher Building Limited	FBU
10	Transpacific Industries Group Limited	TPI

GICS Sector	Ralton	Index	+/-
Consumer Discretionary	37.6%	21.8%	15.8%
Consumer Staples	7.4%	3.2%	4.2%
Health Care	11.6%	8.6%	3.0%
Utilities	3.4%	0.8%	2.7%
Materials	14.5%	14.0%	0.6%
Energy	6.5%	6.2%	0.3%
Telecommunication Services	2.1%	4.8%	-2.7%
Information Technology	2.0%	5.3%	-3.3%
Industrials	12.0%	15.9%	-3.9%
Financials (ex-Property)	2.7%	7.3%	-4.6%
Property	0.0%	12.1%	-12.1%
Total	100.0%	100.0%	

Quarter in Review

Performance Summary

- The S&P/ASX Small Ordinaries Accumulation Index lost 4.04% for the June quarter, with weakness in Financials and Consumer Discretionary the key detractors. For the financial year, the index finished broadly flat, (+0.44%)

- The Ralton Smaller Companies Portfolio fell 4.13%, essentially in line with the benchmark, however for the financial year, the portfolio added 8.93%, outperforming by 8.49%

- For the quarter, the portfolio's overweight position in Healthcare was the key detractor to portfolio returns, offset by our overweight position in Consumer Staples

Portfolio Commentary

Quarterly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Blackmores Limited	Overweight	Virtus Health Limited.	Overweight
Pact Group Holdings	Overweight	Greencross Limited	Overweight
Nufarm Limited	Overweight	Cash Converters	Overweight

Positive Contributors

Vitamin manufacturer and distributor Blackmores Limited (BKL, +37.8%) was again a strong contributor to portfolio returns during the quarter, the stock having gained 177% over the past 12 months. Revenue and profit growth in the Australian business has been very strong as its key competitor, Swisse, has reduced its irrational pricing and promotional activity. Sales to Asia which account for some 15% group sales have been growing at a lower rate. However, after a recent meeting with management we believe Asia is where the medium term growth lies. The Chinese already have a very favourable view of the products, as they have been a driver of Australian sales. Asia offers a large market and BKL have taken the right steps in establishing their presence patiently in these countries. Over many years BKL have invested in branding, supply chain, regulatory capability and built strong distribution channels. In the short term, the stellar rise of the stock has seen us trim our position, although we retain a significant exposure to the medium term growth opportunity.

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.

Nufarm (NUF, +8.7%) again moved higher in the June quarter after posting solid profit results for the first half of their financial year. NUF has made considerable progress in restructuring and refocusing the business along both geographic and product lines. NUF also announced the appointment of current COO Greg Hunt as incoming CEO during the quarter. 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 cost savings that NUF have set. 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.

Underperformers

Virtus Health (VRT, -26.7%) was the largest detractor from portfolio returns for the quarter. The shares fell heavily after the company lowered profit guidance for the FY15 financial year, by approximately 10%. VRT attributed the profit downgrade to a number of essentially one-off factors. Whilst the downgrade was frustrating, we continue to believe that VRT retains a strong position in an attractive segment of the healthcare sector. We expect that VRT's world leading skills in the IVF field can be transported offshore and look for the next acquisition to begin consolidation of the UK market in coming years.

Greencross (GXL, -28.0%), an operator of pet care stores and veterinary clinics, weighed on performance for the portfolio during the quarter. The weak share price performance followed a profit downgrade by the company in early May. GXL cited issues around weather on the Eastern Seaboard impacting their 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.

Cash Converters (CCV, -22.2%) also weighed on portfolio returns for the quarter. The share price has struggled of late, with negative media attention focused on poor lending practices across parts of the payday lending industry. Such attention is frequently emotive and does not capture the highly regulated nature of the industry (including numerous consumer protection measures). CCV's recent half year results, highlighted the challenging conditions for the company's UK operations. The UK remains a work in progress post recent regulatory changes. However, we expect CCV will either improve the returns from this division or significantly wind down the operations by the end of this calendar year. This will remove the UK losses and end a major management distraction.

Portfolio Adjustments

During the Quarter we...

SOLD: Austbrokers Holdings Limited (AUB), Automotive Holdings Group (AHG), Auckland International Airport (AIA), Slater & Gordon (SGH)

BOUGHT: Freedom Foods Group Limited (FNP), G8 Education Limited (GEM), Independence Group NL (IGO), Orora (ORA), Qube Holdings (QUB)

Portfolio Additions

We added several stocks to the portfolio during the quarter as the market pull-back allowed us to reposition the portfolio. You may note that a few of the stocks have been previously owned in this portfolio. To make it back into the portfolio, generally, the stocks have fallen to a level where we see value again and/or catalysts we were waiting for have been delivered.

Qube holdings (QUB) had been in the portfolio for several years and benefitted from a strong period of both organic and acquisitive growth. We had removed the stock as there were some key risks and it was trading expensively. Firstly, we had a concern around the company's exposure to lower quality mining companies. QUB has now had an earnings downgrade which we believe deals with a key part of this risk. Secondly, the company was in negotiations with the Federal government about the Moorebank Intermodal site. Key commercial terms for QUB to develop its site and the government's adjacent site have now been reached. So our stock addition was made after the recent stock price pull-back, the increased earnings certainty had emerged and the terms being agreed around Moorebank.

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 base metals mining company, Independence Group (IGO) back into the portfolio during the quarter. IGO has interests in the mining of nickel, copper and zinc. The stock had been on our radar for some time given its key assets had been operating well, particularly the Tropicana Gold site. The opportunity presented itself to enter the stock when IGO announced its intention to acquire Sirius Resources (SIR) (a nickel focused mining company) and the share price pulled back. SIR are moving from an exploration to a production company with the development of the 'Nova-Bollinger' nickel discovery in WA. Nova-Bollinger is a top tier asset, with the high grade resource representing one of the top 10 nickel assets in the world. We have a positive view on SIR itself and believe that the acquisition by IGO to be a positive one.

We acquired a small position in diversified food company, Freedom Foods Group Limited (FNP) which offers niche food products in growth categories with high barriers to entry. FNP is engaged in the manufacture of tasty, allergen free and healthy foods. The company's dietary offering includes gluten free, nut free, wheat free and dairy free. The brands include Pactum Dairy, Australia's Own Organic, Brunswick Foods, Paramount Salmon and Almond Breeze. FNP is also a material shareholder in the A2 milk company. The group will benefit from substantial expansion of its manufacturing facilities in Sydney and at Leeton, and its expansion in the US market in coming periods. The most important driver will be the ramp-up of the Pactum Dairy Group facility at Shepparton (part of a 50/50 joint venture) with an initial capacity of 100m litres.

We added childcare centre operator G8 Education (GEM) back into the portfolio in April, having sold the stock some 12 months earlier at a substantially higher price. The weakness was driven in part by regulatory concerns (potential for significant changes in government funding following from the Productivity Commission (PC) Review). The market was also concerned that GEM's acquisition driven growth model was unsustainable when coupled with a 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 final report, we felt that the share price weakness was overdone and began to rebuild a position in the stock.

Portfolio Disposals

During the quarter we sold the last of our holding in Austbrokers Limited (AUB). We had previously flagged our concerns in relation to the premium cycle (and likelihood of further falls in premiums) and the impact on AUB's commission income stream. We were also concerned about the increased competitive tension in the market for insurance broking business with the listing of Steadfast as a competitor. This may have crimped AUB's capacity to make acquisitions at the previous attractive levels. We still like the business and management and should our view on these key issues change, we will look to revisit AUB.

We also sold our long held investment in Slater and Gordon (SGH). The legal firm has grown strongly through acquisition in Australia and the UK. SGH announced a major acquisition of a distressed legal practice in the UK. The acquisition price was very large relative to SGH's then size. Although we had been impressed by management, we believe that this company transforming acquisition brings with it significant execution risks, so we elected to sell the holding. Since our disposal, concerns about SGH's accounting practices in the UK have arisen and the share price has fallen appreciably.

Finally, we disposed of our holding in Automotive Holdings (AHG) as we viewed the stock had reached fair value. The proceeds were then deployed into some of the acquisitions made during the quarter.

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)

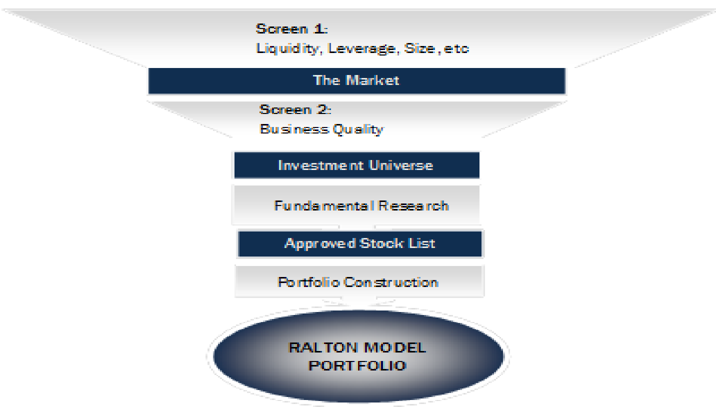
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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