Ralton High Yield Australian Shares

Monthly Report
July 2015

RALTON ASSET MANAGEMENT

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	MORNINGSTAR ★★★★ · Approved Lonsec Research

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	National Australia Bank Limited	NAB
2	Commonwealth Bank of Australia	CBA
3	Westpac Banking Corporation	WBC
4	ANZ Banking Group Limited	ANZ
5	Woodside Petroleum Limited	WPL
6	Woolworths Limited	WOW
7	QBE Insurance Group Limited	QBE
8	Incitec Pivot Limited	IPL
9	CSL Limited	CSL
10	BHP Billiton Limited	BHP

GICS Sector	Ralton	Index	+/-
Consumer Discretionary	15.2%	4.4%	10.8%
Materials	15.9%	14.0%	2.0%
Energy	6.7%	4.8%	1.8%
Industrials	8.2%	7.3%	0.8%
Health Care	7.1%	6.3%	0.8%
Consumer Staples	7.2%	6.7%	0.5%
Utilities	2.0%	2.1%	-0.1%
Information Technology	0.0%	1.0%	-1.0%
Financials (ex-Property)	35.9%	39.4%	-3.6%
Telecommunication Services	0.0%	5.9%	-5.9%
Property	1.8%	7.9%	-6.1%
Total	100%	100%	

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton High Yield	4.47	1.15	16.11	20.20	13.68	8.41
Income Return	*0.00*	*0.67*	*4.47*	*4.69*	*4.89*	*4.94*
Growth Return	*4.47*	*0.47*	*11.63*	*15.52*	*8.78*	*3.47*
S&P/ASX 300 Acc. Index	4.31	-0.81	5.51	14.75	9.42	4.50
Difference	**0.16**	**1.96**	**10.59**	**5.45**	**4.26**	**3.91**

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

Monthly in Review

Performance Summary

- The S&P/ASX 300 Accumulation Index rose in July, adding 4.31%, with Healthcare and Consumer Staples the top performing sectors.
- The Ralton High Yield Model Portfolio added 4.47% for the month, outperforming the benchmark by 0.16%.
- Our overweight position in Industrials and Consumer Discretionary stocks added value, offset to some degree by the portfolio's cash holding in a rising market.

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Asciano Ltd	Overweight	Transpacific Industries	Overweight
Orora Limited	Overweight	Incitec Pivot	Overweight
Amcor Limited	Overweight	Coca-Cola Amatil	Overweight

Positive Contributors

Shares in Asciano Limited (AIO, +22.3%) were boosted by a takeover bid from Brookfield Investment Management which offered $9.05 per share for the company. The offer price is a mixture of cash and shares in US-listed Brookfield Investment Partners. Asciano disclosed the offer to the market following media speculation, noting the Brookfield proposal was highly conditional and subject to a range of matters, including due diligence. Like many takeovers, there's some water to flow under the bridge, hence we elected to take some profits in AIO. We have a very positive view of AIO's assets and believe there's good reason for a bid by Brookfield (and potentially others), hence we maintain a material stake in AIO.

Packaging companies, Orora Limited (ORA, +11.5%) and Amcor Limited (AMC, +5.0%), were the two next best contributors to portfolio returns. There was little in terms of news flow for ORA during the month to justify the move in share price, noting only that the share price had pulled back in recent times – providing the opportunity for the portfolio to re-acquire a holding. ORA completed the sale of now surplus land in Petrie, Queensland, to the local council for $50m. These funds coupled with the company's strong cash flow means ORA is in a position to make material acquisitions or alternatively to return excess capital to shareholders.

During the quarter, Amcor announced the acquisition of an Indian packaging company, PIPL, for US$26m. Amcor has some 30% of its group sales in 'emerging markets' and already has a strong presence in India, so this modest acquisition adds to its in-country capability. Growth in the middle classes is a key driver for consumption of packaged goods – as people's income rises they move away from eating fresh food and toward packaged products. India has some 270 million people classified as middle class, with this figure set to double by 2030, due to both population growth, but more so income growth. Such dynamics are highly favourable to Amcor and the global food producers that are essentially AMC's customers.

Underperformers

Waste services company, Transpacific Industries (TPI, -7.8%), underperformed the market and weighed on portfolio returns. Recent years have been quite disruptive for TPI, with the business undergoing management change, asset sales and substantial organizational change. We remain optimistic on the outlook for the transformation of the business over the next few years. In particular, a revamped sales model should drive improved asset utilisation, and therefore drive profit growth. In July, TPI appointed Vik Bansal to the position of CEO. Mr Bansal has most recently headed Valmont Industries in the US, however he has considerable experience in corporate Australia. We expect to hear more about his plans for the company with the full-year results in August.

Global explosives and fertilizer manufacturer, Incitec Pivot (IPL, -6.0%), also weighed on portfolio returns for the month, with investors focused on gas supply issues at their Queensland Moranbah plant. The plant is relatively new and is responsible for the production of ammonia nitrate for Queensland customers. Specifically, the plant's gas supplier, Arrow (a JV between Petro China and Shell), has encountered issues with their gas production, which in turn has resulted in reduced gas supply to all their customers, including the IPL plant. This has forced IPL to curtail production forcing them to source alternative supply for their own customers at additional cost. We understand Arrow's contractual obligations require them to make every effort to improve the gas supply problem and that the incentives to do so are significant. While not ideal, the impact on IPL as a whole is modest, however, investors were all the same unnerved and the stock sold down.

Coca-Cola Amatil (CCL, +1.4%) was largely flat for the month and hence underperformed against the broader rise in the market. 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 of the business being put in place by Alison Watkins (Managing Director).

Portfolio Adjustments

During the Month we...

SOLD: nil

BOUGHT: SAI Global (SAI)

Portfolio Additions & Material Adjustments

We added a small position in SAI Global (SAI) to the portfolio in July. SAI has had a busy couple of years, with proposed takeover activity failing to complete, a short-lived CEO in Stephen Porges, an interim CEO in the form of Chairman, Andrew Dutton, and more recently the internal appointment of Peter Mullins as CEO, having most recently headed up the SAI property division. In a recent meeting we had with the CEO, we gained confidence about the strategic changes he is making to the business and the options for the standards Australia contract (a key component of earnings). Mullins is undertaking considerable organisational change, centered around familiar themes of improved efficiencies and business realignment. On this last front, SAI is merging three key divisions under one banner and will look to drive the cross selling of services across assurance, compliance and standards. He is really moving the business down the path where many of Australia's major professional service firms headed many years ago. This gives us a degree of comfort that his actions should drive future revenue and profit growth.

Finally, we increased our holding in each of IPL, Origin Energy (ORG) and ORA, the latter well timed at the very start of the month.

Portfolio Disposals & Material Adjustments

We reduced our holding in both Sonic Healthcare (SHL) and AIO during the month. Shares in the global pathology company have fared well in recent times, boosted by the recent acquisition of the Switzerland-based business called Medisupport for $A445m. Conditions in the company's US operations are also likely to have been improving if peer results for US-listed Quest and Labcorp are any guide. Despite this, pathology volumes in Australia have remained somewhat below trend, marking a reasonable headwind for group profits. This, together with the valuation of SHL, reached the point where we felt trimming the position was justified.

With AIO, the share price had been boosted by the potential acquisition by Brookfield Infrastructure, and given the rise in the share price and some uncertainty as to the timing of a formal bid and the nature of the offer, we elected to take some profits.

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