RALTON ASSET MANAGEMENT

Ralton Leaders

Monthly Report August 2015

Investment profile

A professionally managed portfolio of Australian shares

The Ralton Leaders 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 Leaders SMA is to provide investors with long-term capital growth and tax-effective income from a portfolio of blue-chip Australian shares. The portfolio aims to deliver returns that are consistently above the S&P/ASX 100 Accumulation Index over a three to five-year period.

Key portfolio features	
Inception	1 February 2008
Benchmark	S&P/ASX 100 Accumulation Index
Authorised investments	Companies in the S&P/ASX 100 Index or those among the top 100 by size
Number of stocks	25-40
Cash allocation	0% to 10%
Tracking Error	1.5% to 3.5%
Investment horizon	At least 3 to 5 years
Ratings	MORNINGSTAR ★★★★

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Leaders	-6.70	-6.30	7.55	15.46	11.01	6.40
Income return	*0.63*	*0.71*	*3.66*	*4.16*	*4.43*	*4.41*
Growth return	*-7.33*	*-7.01*	*3.89*	*11.31*	*6.58*	*1.99*
S&P/ASX 100 Index	-7.93	-8.65	-2.67	11.89	8.70	4.01
Difference	**1.23**	**2.35**	**10.22**	**3.58**	**2.31**	**2.39**

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

The portfolio is designed for investors who...

- Seek long-term capital growth and tax-effective income.
- Expect consistent above-market returns.
- Have a long-term investment horizon of at least 3-5 years and accept the risk of equity markets.

Portfolio structure

No.	Company name	ASX Code
1	National Australia Bank Limited	NAB
2	CSL Limited	CSL
3	Commonwealth Bank of Australia	CBA
4	Westpac Banking Corporation	WBC
5	BHP Billiton Limited	BHP
6	ANZ Banking Group Limited	ANZ
7	Amcor Limited	AMC
8	QBE Insurance Group Limited	QBE
9	Woolworths Limited	WOW
10	Aristocrat Leisure Limited	ALL

GICS sector	Ralton	Index	+/-
Health Care	12.5%	6.2%	6.3%
Consumer Discretionary	7.9%	3.0%	4.9%
Industrials	10.0%	6.9%	3.1%
Information Technology	2.2%	0.6%	1.6%
Energy	5.7%	4.4%	1.3%
Materials	15.7%	14.5%	1.2%
Consumer Staples	6.3%	7.2%	-0.9%
Utilities	0.0%	2.4%	-2.4%
Telecommunication Services	1.6%	5.9%	-4.3%
Financials (ex-Property)	36.0%	41.1%	-5.0%
Property	2.1%	7.8%	-5.8%
Total	100.0%	100.0%	

Month in review

Performance summary

- The S&P/ASX 100 Accumulation Index fell heavily in August, posting a loss of 7.93%, amid significant market volatility. All sectors recorded a negative return with Energy and Information Technology recording the largest percentage falls.

- The Ralton Leaders Model Portfolio fell 6.70%, outperforming the benchmark index by 1.23%.

- Our overweight position in Consumer Discretionary, together with an elevated cash holding, added value to the portfolio for the month, offset by our Consumer Staples exposure for the period.

Portfolio commentary

Monthly performance attribution

Top contributors	Positioning	Key detractors	Positioning
BlueScope Steel Limited	Overweight	Coca-Cola Amatil	Overweight
Asciano Limited	Overweight	Woolworths Limited	Overweight
Echo Entertainment	Overweight	Brambles Limited	Overweight

Positive contributors

August was one of the most tumultuous periods we have seen in the Australian market for many years. The market had fallen back to the level it last saw in December 2014. Ralton had been concerned about the level the market was trading at for some time and had cash / cash equivalents (i.e. takeovers pending) equivalent to levels comfortably greater than 10% in each of its portfolios.

Despite the large fall in the market, as always reporting season was a driver of short-term share price movements. The portfolio's top performer was Bluescope Steel (BSL, +18.7%). Shares in the diversified steelmaker responded well to a strong profit result, with the performance of the Australian steelmaking business exceeding the market's low expectations. Secondly, and following on from our comments in last month's report, BSL announced a clear strategy for improving the profit of both the Australian and NZ steelmaking operations. Specifically, in regard to the larger Australian steel operations at Port Kembla in NSW, the company announced its intention to either reduce costs of production by $200m per annum or, if this could not be achieved, take the more drastic step of mothballing or shutting the steelmaking foundry. This drastic move is in response to the falling price of imported steel, impacted by the stuttering Chinese economy and the need for China to export excess steel production into Asia. Of the $200m cost saving being targeted, about half of this figure will come from labour costs, including the loss of some 500 jobs. Although, philosophically, we would prefer to see the steelmaking capability remain in Australia, this bold strategy appears eminently rational from our vantage. Stakeholders – the company, employees, governments and unions – will now be working toward a deadline BSL has set, namely the company's November AGM.

Confirmation of a takeover bid from Brookfield Infrastructure Partners (BIP) saw Asciano Limited (AIO, +4.4%) gain ground in a weak market. The final bid of $9.15 has been recommended by the AIO board and comprises cash of $6.94, together with shares or scrip in the US listed BIP, equivalent to A$2.21 per share at the time of the offer. Ahead of deal closure, AIO is aiming to pay a special dividend of up to $0.90, fully franked. The cash offer will be reduced by the value of the special dividend, whose attraction, of course, is the additional franking credit that will be provided to investors.

Echo Entertainment (EGP, -2.0%) reported strong profit results for the full year. Profits (EBIT) rose by 30% boosted by improvements in revenue and profit for both domestic and VIP segments. Under new operational management, the assets have now delivered strong results in recent periods. Following July's announcement by the Queensland government, Echo and its partners in the 'Destination Brisbane' consortium, including Chow Tai Fook Enterprises (CTF) and Far East Consortium (FEC), will now be responsible for building what will become a key feature of the Brisbane city landscape. We should get more details about the financial arrangements for the casino over the next couple of months. During the month, we used the strong run in the share price to take some profits, although we maintain a solid exposure.

Underperformers

Coca-Cola Amatil (CCL, -9.5%) underperformed for the period and was the largest single detractor from the portfolio for August. CCL's half-year profit results were in line with our expectations. Although year-on-year profit growth was largely flat, the results demonstrated stability in profits and volumes of key products – a critical juncture given recent downward trends have been reversed. 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).

Woolworths (WOW, -7.7%) also weighed on portfolio returns for the month. Like most turnarounds, mixed progress is not altogether unexpected in the early days. The company's turnaround plans, announced in May at their investor day, were the trigger for Ralton to invest in WOW. We view the recent appointment of Gordon Cairns as Chairman as positive and now look to both the appointment of a well-credentialed CEO by year's end and some definitive progress in terms of strategic changes being made at each of the key business divisions. From the FY15 results, our view was that the company is sounding more confident that hardware chain Masters was deriving improved sales results from new initiatives and store format under divisional CEO, Matt Tyson. Offsetting this, sales growth at core supermarket divisions continues to stutter (recent initiatives and investments will likely require some 12 months plus before any customer momentum will be visible).

Brambles (BXB, -9.6%) also weighed on portfolio returns. The share price has been weaker in recent months despite the weakness in the Australian dollar, however, this boosts the value of $AUD reported profits. Brambles' global transport business is typically a stable exposure to global product demand – many of the everyday items Brambles moves via its traditional CHEP pallet business, newer age Rigid Plastic Containers (those shiny display pallets used for supermarket fruit) or more specialised products, are less economically sensitive than many internationally traded goods. The share price has weakened of late, perhaps owing to concerns around trade flows and the overall state of emerging markets. BXB has exposure to emerging markets, with some 15% sales coming from non-Western countries. Most of BXB's business in these markets is driven by domestic consumption, not trade-based exports in the short term. Clearly the two are not completely unrelated, but certainly we believe BXB's overall exposure to emerging markets is manageable. In the medium term, consumer demand for Western goods and supply-chain sophistication is the driver of BXB's services and, on this basis, we remain positive.

At the full-year results, BXB highlighted the need to boost growth capital expenditure in coming years. Our recent meeting with management highlighted the bulk of the additional $500m being flagged over four years is due to growth in customer demand hence, such investment is a positive. BXB achieved outstanding returns on incremental capital and we are attracted to companies that can invest capital and achieve strong returns in the current low-growth climate and, to this end, we elected to increase our position in BXB during August

Portfolio adjustments

During the month we...

DECREASED: Echo Entertainment Group (EGP)

INCREASED: Brambles Limited (BXB), Sonic Healthcare Limited (SHL), Woodside Petroleum Limited (WPL)

Portfolio additions

Share price weakness saw us add to three existing positions during the month, namely BXB, Sonic Healthcare (SHL) and Woodside Petroleum (WPL). Woodside has been tracking the oil price lower and we took a recent dip in the oil price to modestly increase our holding in WPL.

Portfolio disposals

As flagged, we reduced our holding in EGP during the month.

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 seven 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 seven 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.

More information

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