Ralton High Yield Australian Shares

Quarterly Report
September 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 among 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

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton High Yield	-1.37	-3.51	8.91	15.75	11.40	7.10
Income return	*0.70*	*1.39*	*4.29*	*4.73*	*4.96*	*5.02*
Growth return	*-2.07*	*-4.90*	*4.63*	*11.02*	*6.43*	*2.09*
S&P/ASX 300 Acc. Index	-2.86	-6.47	-0.66	9.09	6.29	2.92
Difference	**1.49**	**2.96**	**9.58**	**6.66**	**5.11**	**4.18**

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

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	Asciano Limited	AIO
6	Woodside Petroleum Limited	WPL
7	Incitec Pivot Limited	IPL
8	QBE Insurance Group Limited	QBE
9	Aristocrat Leisure Limited	ALL
10	CSL Limited	CSL

GICS sector	Ralton	Index	+/-
Consumer Discretionary	15.8%	4.7%	11.1%
Industrials	11.2%	8.0%	3.2%
Health Care	8.8%	6.4%	2.4%
Materials	16.0%	13.9%	2.0%
Energy	5.3%	4.0%	1.4%
Consumer Staples	7.9%	7.1%	0.8%
Information Technology	0.0%	1.1%	-1.1%
Utilities	0.0%	2.3%	-2.3%
Financials (ex-Property)	33.4%	38.4%	-5.0%
Telecommunication Services	0.0%	5.7%	-5.7%
Property	1.6%	8.4%	-6.8%
Total	100%	100%	

Quarter in review

Performance summary

- The S&P/ASX 300 Accumulation Index fell 6.47% for the quarter with Energy recording a near 25% fall and the Materials sector, predominantly resource stocks, also weighing heavily on the market.

- The Ralton High Yield Model Portfolio fell 3.51% for the quarter, outperforming the benchmark by 2.96%.

- For the quarter, our overweight position in both Consumer Discretionary and Industrials added value to the portfolio, as did stock selection within the Materials sector.

Portfolio commentary

Quarterly performance attribution

Top contributors	Positioning	Key detractors	Positioning
Asciano Limited	Overweight	Transpacific Industries	Overweight
Incitec Pivot Limited	Overweight	Sky Network Television	Overweight
Macquarie Atlas Roads	Overweight	Sky City Entertainment	Overweight

Positive contributors

Asciano Limited (AIO, +26.3%) - shares in AIO were boosted by a takeover bid from Brookfield Investment Management which was first disclosed to the market in July and then endorsed by the board in August. The final bid of $9.15, which was recommended by the AIO board, comprises cash of $6.94 together with shares or scrip in the US listed, BIP, equivalent to $AUD2.21 per share at the time of the offer. Of the $6.94 cash, the proposal includes payment of a special dividend of up to $0.90. The dividend will be subtracted from the total cash payment, but will attract franking credits for investors. We have a very positive view of AIO's assets and believe there is good reason for a bid by Brookfield. Like many takeovers, we have somewhat mixed feelings. The short-term capital benefit is very pleasing, however an Australian listed asset whose value collectively was not being appreciated by the market, has been sold to foreign investors whose time frames are longer dated.

Incitec Pivot (IPL, +12.7%) - also added value to the portfolio in a negative quarter for the market. An investor tour to Louisiana showcasing the US Ammonia Nitrate plant was well received by investors. Our readers would be familiar with our view, namely that this plant will be a key driver of cash flow, returns and ultimately, capital management to shareholders. At current US gas (production) prices and allowing for current US selling prices of Ammonia Nitrate, this plant will offer exceptional returns for IPL. News the plant is essentially on budget and on time contributed to the near 13% gain for the quarter.

Macquarie Atlas Roads (MQA, +22.3%) – added value for the quarter, outperforming many of its infrastructure peers. MQA's key asset, the French Toll Road, APRR, continues to deliver modest profit growth, driven by traffic growth, price increases and cost savings. With the ECB currently 'printing money' in an effort to drive inflation (and avoid deflation), MQA is a likely beneficiary of these measures, as its toll increases are linked to inflation in France. At a group level, MQA continues to simplify its debt structure, reduce its debt, and therein interest paid, which overall should allow for growth in dividend payments going forward.

Underperformers

Transpacific Industries (TPI, -11.7%) - waste services company, TPI, underperformed in a weak market and weighed on portfolio returns. Recent years have been quite disruptive for TPI, with the business undergoing management change, asset sales and significant restructure and re-organisation of business functions. However, despite the share price fall during the period, we felt the August profit results contained some distinct positives. In particular, we would point to recent changes in the sales model and highlight that progress was evident on this front for the main Cleanaway business. Secondly, the benefit of waste internalisation – delivering waste to your own company's landfill – was also evident following the acquisition of a key landfill asset in Victoria. In July, TPI appointed Vik Bansal to the position of CEO. Mr Bansal has most recently led Valmont Industries in the US, however he has considerable experience in corporate Australia and hence his desire to return home to assume a CEO role. Our recent first meeting with Mr Bansal left a positive impression, however investors will be looking to what progress he is able to make in what has been a challenging company to manage in recent times.

Two of our mid-cap, New Zealand-focused stocks weighed on portfolio returns for the period.

Sky Network Television (SKT, -20.7%) - pay TV operator, SKT, was sold down on concerns for a flat profit outlook in coming years. SKT is the dominant pay TV provider in NZ and is a strong and stable business. Despite this, we recognise the competition for people's entertainment dollar is intensifying. Although noting the recent negative trends in eyeballs and marketing dollars in the largest pay TV market, the US, we tend to believe the industry will endure, although in NZ we note the outlook for profit growth in the short term is muted as competition continues to nip at SKT's heels.

Sky City Entertainment (SKC, -9.6%) - despite growing profits at near 9%, casino operator, SKC, also detracted from portfolio returns. The healthy profit growth of the group masked a poor result for the Adelaide casino, including visitor numbers for the partially refurbished Adelaide casino being down year on year and below market expectations. Given the ongoing disruption to the casino and surrounds, such an outcome is not altogether surprising, although expectations of better results for this period had been building. SKC continues to progress its development opportunities in both Adelaide, where additional shopping and car park facilities will be built, and also the flagship Auckland casino, where SKC is commencing a major expansion project.

Portfolio adjustments

During the quarter we...

SOLD: Energy Developments Limited (ENE)

BOUGHT: SAI Global Limited (SAI)

Portfolio additions

SAI Global (SAI) - we added small position in 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 upon 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 capture synergies and, in particular, drive 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 his actions should drive future revenue and profit growth.

Portfolio disposals

We also made one outright sale from the portfolio during the quarter.

Energy Developments (ENE) - we also sold our position in ENE during the quarter. ENE's board and major investors have agreed to a takeover of DUET Group (DUE) at $8 per share. By selling the stock on market, we have effectively accepted the offer price, adjusted for the time value of money.

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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