Ralton Dividend Builder

Portfolio Report | September 2021

Key facts

Income versus growth target

Income — Growth

Market cap bias

Large — Small

Investment strategy

A portfolio of ASX-listed equities designed to provide attractive tax-effective income

Investment objective

Outperform index by over 3% p.a.

Benchmark index

S&P/ASX 300 Accumulation Index

Portfolio Manager

Will Riggall

Inception date

February 2008

Management fee

0.75% p.a. (may vary across platforms)

Number of stocks

25-35

External ratings

Zenith "Approved"

Key platforms

HUB24, NetWealth, Praemium, OneVue, Powerwrap, Linear, Xplore, Wealth02

Stock spotlight | Telstra (TLS) +14.17%

On the last day of June, Telstra delivered a blow out price outcome with the sale of 49% of its tower business. Telstra trades at roughly 8 x EBITDA, however sold a minority interest for 28x EBITDA. While everyone loves to hate Telstra, we have been very positive as we see abating headwinds, increasing competitive advantage and the likelihood that Telstra is about to show medium term growth, its been a long time since this was the case. The key driver will be its mobile business which should see increased revenue and expanding margins as customers take up 5G handsets, whereby Telstra is set to monetise on its strong competitive advantage. We expect the company to sustain a 5% dividend yield. Key tenants our investment thesis were present at the FY21 result, with near term catalysts we are positive on the outlook.

Performance (%, returns greater than one year are per annum p.a.)

At month end	1 mth	3 mth	1 yr	3 yr	5 yr	10 yr	Inception
Ralton	**-0.94%**	**2.73%**	**29.85%**	**5.62%**	**8.25%**	**11.71%**	**7.73%**
Income	*0.91%*	*2.08%*	*4.99%*	*4.77%*	*4.76%*	*4.84%*	*4.99%*
Growth	*-1.85%*	*0.65%*	*24.86%*	*0.85%*	*3.49%*	*6.86%*	*2.74%*
Index	**-1.89%**	**1.79%**	**30.86%**	**9.87%**	**10.52%**	**10.77%**	**6.39%**

Portfolio Performance

The Ralton Dividend Builder portfolio returned +2.73% for the quarter, 0.95% ahead a solid return for the ASX300. The prospect of opening economies was offset by increasing risks of corporate failure in the Chinese property market as Evergrande teetered, inflation and the Fed

Contributors	Comment
SIQ (+31.56%)	SIQ received a bid from global PE firm TPG. The price at $10.35 is attractive at a 60% premium to our average entry price. The price reflects the improving outlook and strong cashflow. We will be patient to receive full value.
SKI (+28.77%)	Spark Infrastructure surged in July as it was the recipient of two takeover proposals from Ontario Teachers and KKR Private Equity. Continued low funding costs and pension fund demand should see further bids in the space.
DOW (+17.66%)	Downer delivered a strong result, ahead of market expectations, lifting NPAT growth 20%+ from the prior year, with cash flow strong again. Through asset sales and strong execution, DOW moves closer to a lower capital intensive, growth business. We see further upside.
Detractors	**Comment**
RRL (-13.64%)	Despite Regis delivering a strong 4Q production update the weakening gold price over the quarter drove the stock price. We are attracted to the company's operational growth outlook and see a brighter outlook for the commodity.
WOR (-15.16%)	Worley delivered an FY21 result marginally below expectations as global COVID actions limited access to sites. Conversely the outlook looks to have strengthened, with energy transition projects to deliver growth and margin.
NEC (-7.39%)	Nine Entertainment underperformed over the quarter as the market digested Stan's move into sport and further streaming competition. Despite near term competition, advertising & housing tailwinds are set to drive EPS acceleration.

September Quarter Market Commentary

Concerns related to the pandemic delta wave, supply chains, iron ore pricing and the Evergrande crisis sent most global market sharply lower during the month. The MSCI AC World index was down 3.5% last month, with the US and China equity markets both falling close to 5% in September.

During their September meeting, US Federal Reserve (Fed) officials indicated that they expect to soon slow the asset purchases they have been using to support the economy and predicted they might raise interest rates next year. This sent a clear signal that policymakers are preparing to curtail emergency monetary help.

Inflation has moved sharply higher in recent months, elevated by supply chain disruptions and other consequences of the pandemic. Fed officials expected inflation to average 4.2% in the final quarter of 2021, before falling to 2.2% in 2022.

Evergrande epitomises the vulnerability of China's economy. Property development has been a huge factor in China's economic growth and accounts for around 28% of GDP. Ultimately, thanks to state intervention, the chances are slim of a disorderly bankruptcy, however it is also likely to slow down China's economic growth, which may become a problem , especially for Australia's commodity exporters.

Yields on 10-year Australian bonds rose by 22 basis points, to end September at 1.50%. The rise in global bond yields is part of a worldwide bond sell-off as central banks move to reduce pandemic stimulus. The Bank of England in the last week of the month raised the prospect of increasing interest rates as soon as November. Norway delivered the first post-crisis hike among advanced countries, and officials signalled an accelerated cycle to come.

Given current equity pricing, the positives of economic and earnings recovery now appears to be more finely balanced with the risks associated with the pandemic, supply chain disruptions and other inflationary pressures. We therefore maintain a constructive stance towards high quality companies.

Portfolio positioning and outlook

The Ralton process focuses on the convergence of strong company fundamentals with clear valuation discipline and identification of thematic drivers, both macro and industry specific, which together are set to drive sustainable growth and shareholder returns.

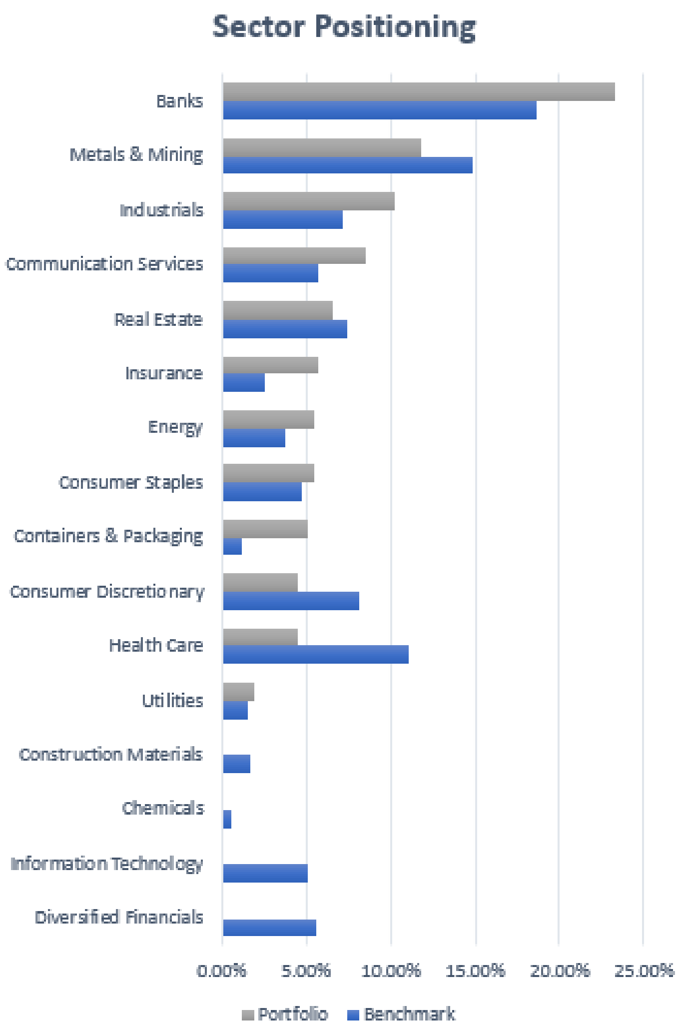
We currently identify a number of key thematics including the trend towards a de-carbonised economy, higher commodity prices and activity driven by a lack of investment as well as a return to higher interest rates collectively driving a rotation to cyclical names, away from unsustainably highly valued components of the market.

At a sector level these drivers, in combination with robust bottom of fundamental analysis positions the portfolio to be overweight Energy and those companies exposed to increased commodity investment, global insurers set to benefit from higher investment returns and strengthening premium rates. As well as a broad set of Industrial names set to benefit from the opening of the global economy.

As a reflection of valuation discipline the portfolio remains underweight Information Technology and Healthcare, while holding selective names where we see an attractive risk/return trade off.

As such key risks to the portfolio performance in the near would be a sharp reversion of the recent increase in global rates however we are conscious to mitigate this risk by continuing to hold Gold names and US housing which benefit from lower rates.

In the event of a major dislocation in global market, our lower than market beta and disciplined focus on valuation should see Ralton continue to deliver its historical trend to outperform in major drawdown.



Top 10 holdings (alphabetical)

Amcor PLC
BHP Group Ltd
Coles Group Ltd.
Commonwealth Bank of Australia
National Australia Bank Limited
QBE Insurance Group Limited
Sonic Healthcare Limited
Telstra Corporation Limited
Westpac Banking Corporation
Woodside Petroleum Ltd

Portfolio metrics

	Ralton	XKOAI
# of Securities	27	200
Market Capitalization	55,727.6	64,861.6
Active Share	65.6	--
Tracking Error	4.53	--
Beta	0.99	1.00
Est 3-5 Yr EPS Growth	11.8	11.0
ROE	8.6	10.6
Div% NTM	4.77	3.64
P/E using FY2 Est	13.9	17.5
Price/Cash Flow	7.3	11.7

Portfolio Activity

BUY	Yield %	Comment
ALX	5.6%	Atlas Alteria (ALX) has an attractive suite of assets in the US and Europe with near term upside as traffic increases from vaccination driven mobility. Earnings are set to accelerate as we look through short term COVID disruptions. Trading at a discount to pre-COVID levels with a sector leading yield we add ALX to the portfolio.
ADH	5.9%	Adairs has successfully leveraged off the large fiscal stimulus measures, online shift as well as the covid themes of work from home. Trading at a discount to peers with a dividend yield close to 6%, we believe the market will re-rate the stock as it understands the strong cyclical tailwinds as well as strong competitive online position.
IAG	4.43%	IAG looks set to benefit from a strong premium pricing cycle with internal cost out efficiencies set to drive insurer margin expansion, delivering growth independent of the economic recovery path. we see the prospect of PE expansion, EPS upside and a better than market yield as an attractive combination.
SELL		
SKI	4.40%	We exit the portfolios position in Spark Infrastructure (SKI.ASX) as we see the revised bid and board acceptance at 2.95cps as highly likely to proceed. The bid values the group at a 1.46 EV/RAB multiple, a premium to it historical and peer trading range and with 2% upside to the bid price we see stronger returns elsewhere.
WES	3.00%	Wesfarmers (WES) has performed well since its addition to the portfolio, delivering a 38% return, 10% ahead of the market over the same period. Looking forward we believe these characteristics are now appropriately reflected in its PE multiple now at 30x, with the dividend now at 3%, 100bps below the target threshold.
CGF	3.40%	We have seen the price to book multiple recovery from a discount to a premium, gaining near 30%. Given the share price recovery, low yielding investment markets as well as the added uncertainty post the announcement that well respected CEO Richard Howes will leave at the end of the year, we exit the position.