Ralton Australian Shares

Monthly Report
May 2015

Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Ralton 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 Australian Shares SMA is to to provide investors with long-term capital growth and some tax effective income from a concentrated portfolio of Australian 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 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	3% to 6%
Investment Horizon	At least 5 years
Ratings	MORNINGSTAR ★★★★ Approved Lonsec Research

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Aust Shares	0.60	0.80	18.38	22.19	12.81	7.96
Income Return	*0.59*	*1.07*	*3.97*	*4.20*	*4.41*	*4.44*
Growth Return	*0.01*	*-0.28*	*14.41*	*17.99*	*8.40*	*3.52*
S&P/ASX 300 Accum. Index	0.43	-1.28	9.93	17.03	10.06	4.78
Difference	**0.17**	**2.07**	**8.45**	**5.16**	**2.75**	**3.19**

**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	Commonwealth Bank of Australia	CBA
2	National Australia Bank Limited	NAB
3	CSL Limited	CSL
4	ANZ Banking Group	ANZ
5	Telstra Corporation Limited	TLS
6	QBE Insurance Group Limited	QBE
7	BHP Billiton Limited	BHP
8	Amcor Limited	AMC
9	Aristocrat Leisure Limited	ALL
10	Incitec Pivot Limited	IPL

GICS Sector	Ralton	Index	+/-
Consumer Discretionary	14.0%	4.6%	9.5%
Industrials	14.2%	7.5%	6.7%
Health Care	9.3%	6.1%	3.1%
Information Technology	1.4%	1.0%	0.4%
Energy	5.4%	5.1%	0.3%
Materials	15.3%	15.4%	-0.1%
Telecommunication Services	5.0%	5.6%	-0.6%
Utilities	1.3%	2.1%	-0.8%
Consumer Staples	2.7%	6.7%	-3.9%
Property	1.9%	7.9%	-6.0%
Financials (ex-Property)	29.5%	38.1%	-8.6%
Total	100.0%	100.0%	

Month in Review

Performance Summary

- The S&P/ASX 300 Accumulation Index added 0.43% for May with Industrials and Information Technology the top performing sectors, offset by weakness in Financials and Consumer Staples

- The Ralton Australian Shares Model Portfolio added 0.60% for the month, outperforming the benchmark by 0.17%

- The portfolio's overweight to Industrials and underweight to Financials added value, offset by the overweight position in Healthcare

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
QBE Insurance	Overweight	ResMed Inc.	Overweight
Amcor Limited	Overweight	Aristocrat Leisure	Overweight
Super Retail Group	Overweight	Oil Search Limited	Overweight

Positive Contributors

QBE Insurance's (QBE, +6.9%) momentum continued into May as positive guidance statements at the AGM in April reaffirmed our view that the turnaround under CEO Neal remains on track. Favourable movements in global bond yields, together with the falling Australian dollar across May also supported the share price. We expect to see improvements in premium growth in the offshore businesses as the company adds new specialty business lines, particularly in the US.

Global packaging manufacturer Amcor Limited (AMC, +3.7%) also boosted portfolio returns. New Amcor CEO, and former CFO Ron Della has recently taken the reigns from long-standing CEO Ken MacKenzie. We expect little change to the Amcor strategy and note that the recent acquisition of Souza Cruz's internal tobacco packaging operations in Brazil for US$30m. We expect bolt-on acquisitions in emerging markets, together with share buybacks to continue to represent a key part of the AMC return drivers.

Super Retail Group (SUL, +8.3%) was also a strong contributor for May. SUL, own a number of major retail brands, is well managed and has expected medium term profit growth driven largely by internal or 'self-help' initiatives. The self-help is largely due to various supply chain, IT and warehousing arrangements that SUL have been investing in over the last couple of years. These will make the business more productive, release inventory (and hence cash) and facilitate future growth. SUL's most recent trading update highlighted mostly positive sales trends in the three core business segments.

Underperformers

Shares in medical technology company ResMed Inc. (RMD, -4.6%) fell after it reported the results of a clinical trial where their breathing devices failed to show a benefit for patients with certain types of chronic heart failure. These are really sick people and it appears that the RMD treatment actually increased mortality in a statistically significant way. RMD were hoping that the use of the 'ASV' device would reduce hospital visits and improve mortality for those treated and in so doing, open up a new market for patients who were suffering from heart failure. Although disappointing, it is unlikely to impact RMD's current treatment of patients with various types of sleep apnea in the medium term, although in the short term it can cause some disruption to sales as doctors reflect on the clinical trial data. As such, we did trim the holding whilst we wait to see the short term impact on quarterly sales.

Aristocrat Leisure (ALL, -6.3%) weighed on portfolio returns, despite reporting strong profit results for the half year. The decline in the share price reflected the soft commentary from management on the outlook. ALL reported half year profit results late in May, including a 67% increase in underlying profit to $110m, by all accounts above most market estimates. The growth in profit was driven by the acquisition of VGT, market share gains in unit sales in Australia and strong profit growth in ALL's digital gaming division. We continue to see further improvement in the company's earnings outlook as it obtains the benefit of increased investment in R&D over the past few years.

Oil Search (OSH, -6.1%), one of April's top performers, reversed course in May and weighted on portfolio returns, largely following the direction of the oil price, with Brent crude oil down approximately 3% for the month. OSH has reacted to the falling oil price by focusing on reducing costs and reprioritizing capital expenditure. The company does remain focused on progressing two key projects which will deliver an uplift in earnings growth later this decade. Firstly, there is a third LNG train with Exxon at the existing PNG LNG facility and secondly, development of the ELK/ Antelope gas fields for either a 1 or 2 LNG train development with partners, TOTAL and InterOil.

RALTON ASSET MANAGEMENT

Portfolio Adjustments

During the Month we...

SOLD: South32 (S32)

BOUGHT: Computershare Limited (CPU), Woolworths Limited (WOW)

Portfolio Additions & Material Adjustments

We added Woolworths (WOW) to the portfolio in May. The company has had a considerable fall in share price over the past 18 months, triggered by deteriorating profit growth at the company's core supermarket's business, together with ongoing losses from the rollout of the poorly performing Master's Hardware chain. Whilst it takes time to change momentum in businesses of this scale, we are of the view management are putting into place the right strategies to transform both businesses.

Taking these in turn, the core supermarket business "Woolworths" has lost its focus on delivering value to its customers and instead appears to have become focused on driving profit growth by increasing its already industry leading margins. This was not a sensible strategy in light of the turnaround at Coles. The new supermarket CEO has highlighted a series of poor decisions that led the business down the wrong path. Going forward, Woolworths will seek to restore customer faith in its low prices by investing heavily in prices', increasing store service (labour) and an improved look and feel to the stores with an accelerated refurbishment program. The investment in price is being driven by a cost reduction program of $500m initially with more to follow. We ultimately expect this will restore volume growth for the business. A key metric for us to monitor will be how much more investment in price is required to drive this volume growth

Masters store format, version 1.0, heavily influenced by joint venture partner Lowe's has been unsuccessful in Australia and the losses have been building. In 2014, WOW brought in Matt Tyson as group CEO of Masters. He has had considerable success with big box hardware formats in several countries. Tyson is leading the changes with Masters 2.0 store format. In simple terms the store format includes more products, stronger brands and has been rejigged to include more exposure to garden and basic hardware. Early signs are positive with two new stores built in 2.0 format and several refurbishments either complete or underway. We believe that Masters 2.0, together with better branding and promotions, can improve its profitability. Like most investors, the board will not tolerate circa $200m loss for ongoing periods. Tyson will either succeed or the division will be sold. Either way, the profit drain will be reduced.

Touching on capital, we expect WOW to reduce the capital directed toward Masters until the 2.0 proves its stripes, together with lower capital directed toward new supermarkets. Instead, additional refurbishment dollars spend will be spent on aged or tired looking stores and is expected to drive an improvement in returns on capital. This underinvestment in the supermarket stores is also a contributor to the problem this business faces.

In summary, with a solid dividend yield and a clear strategy in place to turnaround these operating issues, we felt that the valuation was sufficiently attractive to start buying. Like most turnarounds, we do not expect improvements to occur in a 'straight line' however we do have confidence that it can be achieved.

Secondly, we purchased a position in Computershare (CPU) in May. CPU has a strong position in company share registries and a myriad of other processing type businesses. Until recently, CPU had grown strongly via acquisition; however this has slowed in recent years. We have bought a position in the portfolio with a view that the stock offers reasonable value at these levels. CPU is focused on business simplification and offers upside to any movement in global interest rates (given the large cash balances it holds on behalf of clients).

Finally, we added to our position in National Australia Bank (NAB), via both an increase in the portfolio weighting and taking up our rights for investors in the NAB entitlement offer (capital raise). NAB has raised $5.5bn to deal with legacy issues. The proceeds are to be used to support capital requirements for the IPO of the Clydesdale Bank in the UK and to increase capital in anticipation of new regulatory requirements. We are of the view the management team under Thorburn are finally addressing the legacy issues of the bank and looking to improve the poor culture.

Portfolio Disposals & Material Adjustments

South 32 (S32) was demerged from BHP Billiton (BHP) mid-month, with BHP investors receiving a 1:1 entitlement in the new stock. S32's assets include mining and upstream (processing) facilities across several commodities, including aluminum, thermal coal, manganese and nickel. The assets are non-core to BHP, though represent reasonable quality on a global scale. At this stage, we saw no compelling reason to hold the stock and with the share price trading higher upon listing, we elected to sell the position.

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)

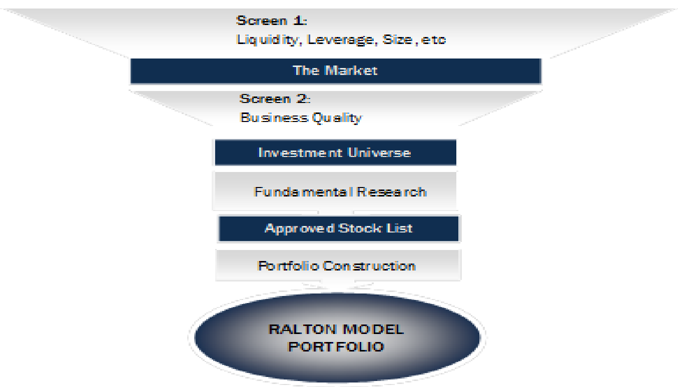
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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

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