

# Ralton High Yield Australian Shares



Monthly Report  
May 2015



## 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	
<b>Inception</b>	1 February 2008
<b>Benchmark</b>	S&P/ASX 300 Accumulation Index
<b>Authorised Investments</b>	Companies in the S&P/ASX 300 Index or those amongst the top 300 by size.
<b>Number of Stocks</b>	20-35
<b>Cash Allocation</b>	0% to 10%
<b>Tracking Error</b>	2% to 5%
<b>Investment Horizon</b>	At least 5 years
<b>Ratings</b>	 

## Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
<b>Ralton High Yield</b>	1.14	1.68	18.30	22.85	13.99	8.61
<i>Income Return</i>	0.53	0.99	4.64	4.84	5.00	5.03
<i>Growth Return</i>	0.62	0.70	13.65	18.01	8.99	3.58
S&P/ASX 300 Acc. Index	0.43	-1.28	9.93	17.03	10.06	4.78
<b>Difference</b>	<b>0.71</b>	<b>2.96</b>	<b>8.37</b>	<b>5.82</b>	<b>3.93</b>	<b>3.83</b>

\*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	Commonwealth Bank of Australia	CBA
2	National Australia Bank Limited	NAB
3	Telstra Corporation Limited	TLS
4	ANZ Banking Group	ANZ
5	Woodside Petroleum Limited	WPL
6	QBE Insurance Group Limited	QBE
7	Arcor Limited	AMC
8	BHP Billiton Limited	BHP
9	Transurban Group	TCL
10	CSL Limited	CSL

GICS Sector	Ralton	Index	+/-
Consumer Discretionary	14.4%	4.6%	9.9%
Industrials	16.4%	7.5%	9.0%
Telecommunication Services	6.9%	5.6%	1.3%
Energy	6.1%	5.1%	0.9%
Health Care	5.7%	6.1%	-0.4%
Utilities	1.7%	2.1%	-0.4%
Information Technology	0.0%	1.0%	-1.0%
Materials	13.2%	15.4%	-2.1%
Consumer Staples	4.1%	6.7%	-2.6%
Property	1.8%	7.9%	-6.1%
Financials (ex-Property)	29.6%	38.1%	-8.5%
Total	100%	100%	

## Monthly in Review

### Performance Summary

- The S&P/ASX 300 Accumulation added 0.43% for May with Industrials and Information Technology the top performing sectors, offset by weakness in Financials and Consumer Staples
- The Ralton High Yield Model Portfolio added 1.14% for April, outperforming the benchmark by 0.71%
- Our overweight position in Industrials, together with an underweight exposure to Financials, specifically bank stocks added value.

### Portfolio Commentary

## Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
QBE Insurance Group	Overweight	Aristocrat Leisure	Overweight
Amcor Limited	Overweight	Sky Network Television	Overweight
Super Retail Group	Overweight	Energy Developments	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

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.

Our mid-cap stock exposures Sky Network Television (SKT, -2.6%) and Energy Developments (ENE, -2.8%) both underperformed the market and therein detracted from portfolio returns. SKT held their investor day in Auckland during the month. SKT's pay TV business is mature and faces competition from new offerings such as Netflix. However, we do believe these risks are more than adequately reflected in the price and the market is currently ignoring the strength of SKT's position given its control of key sporting and film content in New Zealand. Therefore, its offering will continue to be a staple for sport and US sitcom loving homes.

There was no new news from ENE to specifically drive the share price during the month. The government and the opposition appear to have agreed a new Renewable Energy Target (RET). This will provide more certainty for ENE about the demand for the RET certificates it generates, and therefore, the revenue from this segment.

## Portfolio Adjustments

### During the Month we...

**SOLD:** South32 (S32)

**BOUGHT:** 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.

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.



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## 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:

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