Ralton Smaller Companies

Monthly Report
May 2015

Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Ralton Smaller Companies 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 Smaller Companies SMA is to provide investors with long-term capital growth and some tax effective income from a concentrated portfolio of smaller capitalisation ASX listed 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 Small Ordinaries Accumulation Index
Authorised Investments	ASX listed companies that are not included in the S&P/ASX 50 Index
Number of Stocks	25-40
Cash Allocation	0% to 15%
Tracking Error	5% to 9% per annum
Investment Horizon	At least 5 years
Ratings	MORNINGSTAR ★★★★ Approved Lonsec Research

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Smaller Companies	2.51	5.53	15.41	20.27	15.02	7.81
Income Return	*0.09*	*1.19*	*3.14*	*3.61*	*3.70*	*3.82*
Growth Return	*2.42*	*4.34*	*12.27*	*16.66*	*11.32*	*3.99*
S&P/ASX Small Ords Acc Index	2.35	2.03	7.69	3.55	2.22	-1.90
Difference	**0.16**	**3.50**	**7.72**	**16.71**	**12.80**	**9.72**

**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	Super Retail Group Limited	SUL
2	Sky Network Television Limited	SKT
3	Energy Developments Limited	ENE
4	Virtus Health Limited	VRT
5	Macquarie Atlas Roads Limited	MQA
6	Aristocrat Leisure Limited	ALL
7	Pact Group Holdings Limited	PGH
8	News Corporation	NWS
9	Skycity Entertainment Group Limited	SKC
10	Blackmores Limited	BKL

GICS Sector	Ralton	Index	+/-
Consumer Discretionary	41.1%	24.3%	16.7%
Health Care	12.8%	8.5%	4.3%
Consumer Staples	6.5%	2.9%	3.6%
Utilities	3.9%	0.7%	3.2%
Energy	6.1%	5.5%	0.7%
Industrials	13.4%	16.0%	-2.5%
Telecommunication Services	2.1%	4.8%	-2.7%
Information Technology	2.1%	5.1%	-3.0%
Financials (ex-Property)	2.8%	7.0%	-4.2%
Materials	9.2%	13.8%	-4.7%
Property	0.0%	11.3%	-11.3%
Total	100.0%	100.0%	

Month in Review

Performance Summary

- The S&P/ASX Small Ordinaries Accumulation Index had a strong month in May, adding 2.35%, boosted by strong performance from the Materials, Healthcare and Consumer Discretionary sectors.
- The Ralton Smaller Companies Portfolio added 2.51%, outperforming the benchmark by 0.16%
- The portfolio's overweight position in Consumer Staples was the key contributor to our outperformance, offset by our overweight exposure to Healthcare

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Blackmores Limited	Overweight	Fisher & Paykel Healthcare	Overweight
SAI Global	Overweight	Aristocrat Leisure	Overweight
Super Retail Group	Overweight	Cash Converters International Ltd	Overweight

Positive Contributors

Vitamin manufacturer and distributor Blackmores Limited (BKL, +22.8%) was again a strong contributor to portfolio returns, the stock having gained 188% over the past 12 months. Revenue and profit growth in the Australian business has been very strong as its key competitor, Swisse, has reduced its irrational pricing and promotional activity. Sales to Asia which account for some 15% group sales, have in recent periods been growing at a lower rate. That being said, a recent meeting with management has confirmed our view that Asia is where the medium term growth lies. Not only are the markets large, but BKL have taken the right steps in establishing their presence patiently in new countries. Over many years BKL have invested in branding, supply chain, regulatory capability and further, built strong distribution channels. In the short term, the stellar rise of the stock has seen us trim our position, although we retain a significant exposure to the medium term opportunity.

Long standing portfolio holding SAI Global (SAI, +12.7%) added value to the portfolio in May. 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 organizational change, centered upon familiar themes of improved efficiencies and business realignment. On this last front, SAI are 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 that his actions should drive future revenue and profit growth.

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

Fisher and Paykel Healthcare (FPH, -1.3%), one of the portfolio's larger holdings, weighed on performance after recording a modest decline for the month. The full year profit results were stellar, with growth in underlying profit for FPH rising 57% across FY15. Both of FPH's key divisions reported strong revenue growth and FPH have forecast that these trends will continue for the coming year. Gross margins for FPH rose more than 4% across FY15 due to sales mix (higher percentage of consumables), scale benefits and ongoing shift of manufacturing to Mexico, which has a lower cost base and is closer to most of FPH's end markets.

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.

Cash Converters (CCV, -9.3%) weighed on portfolio returns for the month. The share price has struggled of late, with negative media attention focused on poor lending practices across parts of the payday lending industry. Such attention is frequently emotive, however it perhaps does not capture the highly regulated nature of the industry and numerous consumer protections that exist, and that we believe CCV uphold in large part. CCV's recent half year results, highlighted the challenging conditions for the company's UK operations. The UK remains a work in progress post recent regulatory changes, however we expect CCV will either improve the returns from this division or significantly wind down the operations and reduce the current losses and management distractions by the end of this calendar year.

Portfolio Adjustments

During the Month we...

SOLD: *Nil*

BOUGHT: *Nil*

Portfolio Additions & Material Adjustments

We were active in increasing several of our current portfolio holdings across the month. Amongst the stocks that we added to were Ardent Leisure (AAD), Greencross Limited (GXL), New Hope Coal (NHC) and Tassal Group Limited (TGR). Each stock has traded down somewhat in recent periods and we took the opportunity to add to these holdings. We also added to Super Retail Group (SUL) whose share price has risen, as our confidence improved that progress was being made on the company's transformation initiatives.

There were no new outright stock purchases for May.

Portfolio Disposals & Material Adjustments

During the month we took profits in both Fisher and Paykel healthcare (FPH) and Vitamin manufacturer and distributor Blackmores Limited (BKL), with both stocks discussed already in this report.

There were no outright stock sales for May.

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)

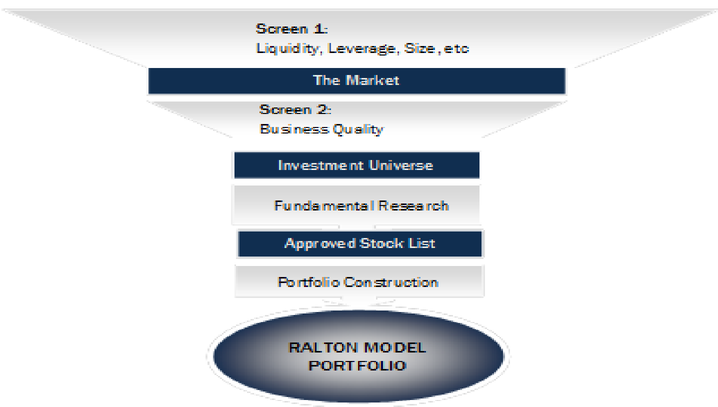
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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:

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