Investment Philosophy

Royston Capital
AFSL 438262

Royston Capital Investment Philosophy focuses on providing investment advice that puts our clients' best interests first. The provision of our investment advice is overlaid with an in-depth understanding of our clients' wealth objectives and taxation considerations.

We seek to preserve the real value of our clients' capital while seeking to prudently enhance wealth over the long term. Our logo uses a stylised family crest to help represent the value of Royston Capital and our heritage. Each of part of the family crest has a traditional meaning:

- White shield symbolises 'peace and sincerity'
- Hourglass symbolises 'flight of time; mortality'
- Helmet denotes 'wisdom and security in defence; strength and protection'
- Chevron symbolises 'protection and faithful service'
- Stars symbolises 'celestial goodness; noble person; excellence'
- Stag symbolises 'peace and harmony'
- Acacia leaves symbolises 'eternal and affectionate remembrance'

We believe that our investment philosophy meets the above values and will help to ensure we continue to place our clients' best interest first, invest ethically, and build wealth

General Approach:

Equities (ASX listed, International listed and private equity)

When investing in equities we seek businesses with conservative balance sheets, solid earnings' growth, and reasonable valuations. Other characteristics we seek include:

- Attractive dividend yield or capacity to pay such over time
- Free cash flow that exceeds debt servicing obligations (not borrowing to pay dividends) and sound capital expenditure management
- Sound and transparent earnings growth
- Earnings predictability
- High quality management and shareholder friendly Board
- Justifiable Price / Earnings ratio (PE)

Fixed interest and interest bearing securities

When investing in fixed interest securities we seek preservation of capital while also seeking attractive income streams. We consider the following variables:

- Credit rating and profitability of underlying issuer
- Ranking within the capital structure
- Floating or fixed rate issue
- Investor protection within the structure
- Liquidity
- Frequency of distributions and availability of franking credits
- Running yield and yield to maturity
- Duration risk
- Conversion discounts and step-up margins
- Other complexities with the structure such as put and call options should they exist

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Property investments

When investing in listed property securities and direct property, including property syndicates, we seek the same fundamentals as described for equities and fixed interest securities including:

- Income security
- Capital growth potential
- Weighted average lease expiry (if applicable)
- Conservative gearing
- Market timing (investment cycle)
- Lease terms and conditions
- Tenant quality
- Asset due diligence (where possible)
- Liquidity (ability to access and withdraw your invested funds)

Alternative and specialist asset classes

From time to time we research and recommend specialist investment funds to access alternative or otherwise difficult to access investments. This is often achieved through specialist who we know well to selectively add value through intensive management and the application of specific skills and expertise. Alternative and specialist investment assets and markets may extend to:

- Emerging market equities
- Emerging market debt
- Hedge funds / absolute return funds
- Commodities and precious metals
- Private equity
- Venture capital
- Infrastructure
- Liquidity (ability to access and withdraw your invested funds)

Managed funds

When researching and selecting fund managers, Royston capital will seek the most recent copy of the relevant Fund Manager's IFSA Investment Management Questionnaire and the Product Disclosure Statement. These documents will be reviewed, discussed and assessed with particular focus on:

- Organisation and People
- Compliance
- Governance Policy
- Investment Philosophy and Investment Style
- Investment Performance
- Custody of Assets
- Customer Service, Administration and Reporting
- Product Fees.

If deemed necessary, the Committee will meet with the relevant Investment Professionals and Senior Management of the Fund Manager.

The Fund Manager's position on ethical issues in light of the Royston Capital's Ethical Stance on investments will be taken into consideration where appropriate for clients of Royston Capital.

ARIF

The Royston-Admiral Australia REIT and Infrastructure Fund (ARIF) will exist as a Managed Discretionary Account under Royston Capital and advised by Admiral Investment. Admiral is an investment manager licensed by the Hong Kong Securities and Futures Commission that focuses in real estate and related investments across Asia Pacific.

The ARIF will be a long only mandate that invests in Australian REITs (A-REITs) and Infrastructure Trust. The goal of ARIF is to provide steady dividend income and capital appreciation through time. The portfolio seeks to outperform the S&P ASX 300 A-REIT Index, on a total return basis, through the medium term. ARIF will be denominated in the Australian Dollar and invested in Australian denominated assets. This mandate invests only in listed vehicles that provide liquidity on a daily basis.

REITs and infrastructure trusts are listed instruments to allow investors gaining exposure to the real estate and the infrastructure sectors. Assets in both sectors are characterized by their relatively stable and transparent cash inflow. Real estate and infrastructure are often seen as inflation hedges, providing growth that is inline with or slightly ahead of inflation through time. Their lease or revenue structure also provides protection during weaker

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markets. REITs have weighted average lease expiry of several years. Infrastructure Trusts are often regulated by the government, but their demand comes from the wider public and is not subject to the rise and fall of any particular industry. Earnings for both sectors are thus predictable and relatively more stable than many alternatives.

Similar to other Australian companies, management teams of A-REITs and Infrastructure Trusts are monitored by the stock market at large. Top management roles are competitive, especially compared to the rest of Asia Pacific. In particular, the annual vote on top management compensation package is seen as a regular referendum on management performance, and every year there are changes in top management.

REITs are also legally required to pay out most of its net income as dividend to qualify for certain tax benefits. While infrastructure trusts are not required by law to pay out dividends, many maintain a respectable yield to stay competitive with REITs and other higher-yield instruments. In Australia, dividend yield in 2015 ranges from 6% to 9%, and tax benefits are available in the form of franking credits.

Management

Board

Is the **structure** (independent chairman, number of Executive Directors, number of Independent Non-Executive Directors, Directors of major shareholders) and **skills** (relevant industry experience, general business experience, ex-regulators, ex-politicians etc.) of the board likely to lead to positive decisions for the company or negative decisions?

Strategic Direction

Does the company have an intelligent, rational vision of what it is and where it wants to head in the future? What is its reason for existing? What is its competitive advantages? How does it service its customers? Can this company expand in a low risk, value accretive way? Historically has the company changed its strategic direction frequently? Is the company's current strategic direction likely to add or destroy shareholder value?

Executive Management

Are the executive management team experienced, intelligent, have the appropriate skill sets and run the company in an optimal manner? Has there been a significant amount of management turnover in the executive ranks? Are CEOs generally internal or external appointments? Does the management team change their strategic direction or operational style regularly?

Alignment of Interests

Does the board and management has a significant stake in the equity value of the company? This can take the form of share ownership, options, restricted stock, STIP and LTIP. Is there a controlling shareholder who has interests that are not aligned with minority equity investors?

Operational Performance

How do the company's operational management perform relative to their peer group? Indicators of performance could include EBITDA margins, ROCE, customer surveys, staff turnover levels among others.

Financials

Balance Sheet Capacity

Can the company take on more debt if needed? If debt markets froze again, would this company be forced to raise equity? ND to EBITDA and Interest Cover ratio are two measures that can be used relative to assets/companies with similar risk profiles. Is the Balance Sheet forecast to get better or worse?

Industry Consolidation

If the industry is consolidating, is this a potential positive or negative share price driver? A positive driver could include the potential for the company to be acquired, it could also include the potential for the company to make acquisitions and extract synergies that add to its own equity value. A negative driver could be a company that overpays and destroys value when acquiring competitors or a company that can't consolidate when its competitors are. Remember around 70% of M&A destroys value for the acquiring company.

Earnings Quality

Do we have a high degree of faith in the company's reported earnings? Does the company regularly make write-downs, acquisitions or change segmental reporting? Does the OCF reconcile with reported profits? Is the business overly complex making due diligence very difficult? Has the company had to restate earnings previously or had accounting scandals in its past?

Earnings Risk

Which direction are the risk to the short term (next 12 months) and long term (5 years) earnings forecasts for the company? Does this company have the tendency to create value for shareholders or destroy it?

Political & legal risks

Any overseas operations? If so does the country or countries the company operates in have an adequate and independent judicial system, rule of law, property rights or a history of government interference in business?

Return on capital

Does this business earn a good return on the capital it employs in its business relative to the risk of the business? ROCE or ROE from the financial models are a good place to start although they do have their limitations.

Cost pass through

To what degree does the operating environment allow companies to 'pass through' cost increases like fuel costs, wage inflation, health care costs or pension expenses.

Operational Risks

Is the company exposed to a high degree of operational risks in its core business which could adversely impact its cash flows or ability to operate?

Capex risk

Does the company have a large capital expenditure program? If so is the company exposed to over runs in capital expenditure projects or does regulation allow them to recover "reasonable costs"?

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