RALTON
ASSET MANAGEMENT

Monthly Report April 2014

Ralton Leaders

Winner of the 2010 Standard & Poors' Fund Awards
- Separately Managed Accounts Category

Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Ralton Leaders 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 Leaders SMA is to provide investors with long-term capital growth and tax effective income from a portfolio of blue-chip Australian shares. The portfolio aims to deliver returns that are consistently above the S&P/ASX 100 Accumulation Index over a three to five year period.

Key Portfolio Features	
Inception	1 February 2008
Benchmark	S&P/ASX 100 Accumulation Index
Authorised Investments	Companies in the S&P/ASX 100 Index or those amongst the top 100 by size.
Number of Stocks	25-40
Cash Allocation	0% to 10%
Tracking Error	1.5% to 3.5%
Investment Horizon	At least 3 to 5 years
Ratings	

The Portfolio is designed for investors who...

- Seek long term capital growth & tax-effective income
- Expect consistent above market returns
- Have a long term investment horizon of at least 3-5 years and accept the risk of equity markets.

Portfolio Structure

No.	Company Name	ASX Code
1	ANZ Banking Group	ANZ
2	Commonwealth Bank of Australia	CBA
3	BHP Billiton Limited	BHP
4	Telstra Corporation Limited	TLS
5	Westpac Banking Corporation	WBC
6	Oil Search Limited	OSH
7	Amcor Limited	AMC
8	Aristocrat Leisure Limited	ALL
9	QBE Insurance Group	QBE
10	CSL Limited	CSL

GICS Sector	Ralton	Index	+/-
Industrials	9.0%	5.9%	3.1%
Health Care	7.9%	4.9%	3.0%
Telecommunication Services	7.3%	4.9%	2.5%
Consumer Discretionary	5.4%	3.5%	1.9%
Energy	8.4%	6.8%	1.6%
Information Technology	1.8%	0.7%	1.1%
Materials	16.4%	17.3%	-0.9%
Utilities	0.0%	1.8%	-1.8%
Property	4.0%	6.6%	-2.7%
Financials (ex property)	36.3%	39.1%	-2.8%
Consumer Staples	3.4%	8.3%	-4.8%
Total	100.0%	100.0%	

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Leaders	1.60	6.81	13.21	10.07	12.88	5.83
Income Return	0.00	1.25	3.64	4.49	4.35	4.54
Growth Return	1.60	5.56	9.56	5.58	8.52	1.29
S&P/ASX 100 Index	1.94	7.30	10.85	10.07	12.92	4.68
Difference	**-0.34**	**-0.49**	**2.36**	**0.01**	**-0.04**	**1.15**

*Since Inception p.a., Feb 2008

RALTON ASSET MANAGEMENT

Month in Review

Performance Summary

- The S&P/ASX 100 finished the month with a solid gain of 1.94%, with Property Trusts and Utilities the best performing sectors in percentage terms.
- The Ralton Leaders Model Portfolio also recorded a solid gain, adding 1.60% for the month, underperforming the benchmark index by 0.34%.
- At a sector level, the portfolio's overweight exposure to Healthcare added to returns, however our underweight exposure to Consumer Staples together with stock selection within Financials detracted from relative performance.

Portfolio Commentary

Month Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
ResMed Inc.	Overweight	QBE Insurance Group	Overweight
Echo Entertainment	Overweight	Coca-Cola Amatil	Overweight
Oil Search Ltd	Overweight	Aristocrat Leisure	Overweight

Positive Contribution

ResMed Inc. (RMD, +14.1%) was a strong contributor to the portfolio in April, reversing recent underperformance. The company's third quarter profit result delivered 8% growth in earnings per share (EPS) and was well received by the market. Critically, sales in the US region, which accounts for about 55% of company sales, demonstrated an improving trend for both masks and breathing devices compared to recent quarters. The result and associated management commentary strongly suggest that recent disruptions caused by changes in pricing and service providers (known as DME's) in the US were abating and that 'business as usual' was returning. RMD is expanding its clinical offering with a full launch of the Astral 150 in Europe later this year targeting the market for invasive and non-invasive life support ventilation for both adult and paediatric patients. This launch, together with new product initiatives and possibly a whole new platform offering in their sleep apnea segment should, in our opinion, drive solid revenue growth and support our investment in ResMed.

Our core energy holding, Oil Search (OSH, +5.1%) benefited from the rising oil price, which was in turn driven by ongoing geopolitical concerns centred on Ukraine and Russia, with Russia of course a major supplier of energy (gas) to Europe and the rest of the world. For Oil Search however, the key news was that commissioning of the PNG LNG gas plant was now running ahead of schedule and on budget, with the first gas shipments likely to leave port during May. Cash flow from the project for the JV partners, Exxon, Oil Search, and Santos, will be significant. For OSH the dollar amounts will prove transformational, allowing scope for the company to increase dividends to shareholders and invest in further projects, such as additional LNG gas trains in PNG. OSH recently acquired a material interest in another PNG gas field, named Elk/Antelope or PRL15. This field, co-owned by TOTAL and InterOil, will likely be used to support further LNG facilities. The size and nature of any future LNG plants will be determined by further field (exploration) works, together with negotiations between the joint owners of PRL15 and the PNG government. We expect clarification on this front over the course of 2014.

A quarterly trading update by Echo Entertainment Group (EGP, +15.1%) outlined that the management action to impove returns is beginning to deliver. Of note, the company confirmed that revenue growth for the main gaming floors of the Sydney and Queensland casinos had improved and is now comfortably in positive territory versus the same period last year. Further, the board confirmed the appointment of Matt Bekier as CEO and Greg Hawkins (former Crown Melbourne CEO), as Managing Director of The Star.

Negative Contribution

QBE Insurance (QBE, -9.7%) reversed its positive start to the calendar year during April. Contributing to the weakness was the ongoing strength of the Australian dollar, (which of course impacts translation of US dollar profits), together with declining government bond yields, which impacts QBE's investment returns and the value of its liabilities. In the short term it appears that bond investors are tempering their view of the US growth outlook following a severe winter that has weakened economic activity in the US. At it's AGM, QBE also announced a 'strategic review' of its US middle market business. This will likely see the company sell this business and we view this as a positive given its subscale operations.

Coca-Cola also detracted from portfolio performance during April (CCL, -16.1%), although most of the fall came after we had significantly reduced the portfolio weighting. CCL has faced substantial headwinds over the past couple of years. These related to increased competition from a Japanese-controlled competitor (lacking profit discipline), de-stocking by the major supermarkets, a soft consumer environment and cost increases in Indonesia arising from a decline in the value of the rupiah and a rise in the minimum wage. In addition, there are rising health concerns about sugar consumption (i.e. is this the next tobacco?). If the health concerns are a factor, we think it will be a long time before it significantly dents consumption. At the time we acquired the initial holding we expected a number of these headwinds would ease in CY14. We reduced our holding in early April after revising our expectations regarding the timing of this.

Later in the month, CCL's new CEO Alison Watkins surprised us with a dramatic downgrade in current year earnings expectations. We are of the view that some of this downgrade is a re-basing of earnings to give the new CEO room to manoeuvre when making some structural changes in the company. Also, there is a recognition that the competition from Schweppes, the soft domestic consumer environment, and Indonesian pressures will all persist in the short-term. We are still a fan of the products CCL produces, the financial returns it has generated over a long period of time, and the growth options presented by Indonesia, and we expect it will get back on the path of profit growth. So we will continue to monitor the progress of Alison Watkins as she conducts a restructure of operations, with a view to adjusting the portfolio weight further at an appropriate time.

Gaming machine manufacturer Aristocrat Leisure (ALL, -6.5%) gave up its recent share price outperformance. There was no news flow from the company, however the strength of the Australian dollar and a mixed update from one global peer perhaps weighed on the share price. As flagged previously, we continue to back the 5-year turnaround plan under CEO Jamie Odell, particularly given clear signs of operating improvement in recent periods.

Portfolio Adjustments

During the Month we...

SOLD: ASX Limited (ASX)

BOUGHT:

Purchases/Additions

Although there were no new stocks added to the portfolio during April, we increased our position in several recent portfolio additions, including CSL Ltd (CSL), Echo Entertainment (EGP), Macquarie Group Limited (MQG) and Origin Energy (ORG).

We contined to add to our position in Macquarie Group Limited (MQG). Since the Global Financial Crisis, MQG has shifted its business model and profit mix, and now receives a higher percentage of its earings from annuity type businesses such as funds management. However, the earnings from the more transactional business of FICC , investment banking and securities have continued to be a drag. We are now seeing signs of life for investment banking in the US and Asia with good volume lifts in the last half. Further, the pending sales by state governments of infrastructure assets should provide a string of opportunities in the Australian market. Finally, the wind-down of US Fed QE3 should see a rise in volatility globally which can be a positive for FICC businesses.

Origin Energy (ORG) continues to progress construction of it's APLNG plant in Gladstone, QLD. As per the company's most recent quarterly production report in April, the Gladstone based LNG plant, known as APLNG, is now nearing 70% complete and remains within budget. First gas shipments are still targeted for CY15. As the project effectively de-risks and cash flow moves closer we believe the stock will continue to re-rate. With several LNG projects set to commence production shortly, the rise in demand for Australian gas to supply these plants, together with the direct link that these gas plants will provide with global oil prices, will see the price of domestic gas rise. Whilst this is certainly a negative for most businesses and consumers in Australia, companies who are 'long gas' should benefit. Origin's annual sales of domestic gas are circa 200 PJ and, as a low cost producer and purchaser of gas, the company should, we believe, benefit from rising prices.

Disposals

The one stock sale for the month was ASX Ltd (ASX), with most of the proceeds used to increase the investment in Macquarie Group Limited (MQG). Whilst we still like the business model, it does face some headwinds given the volume growth for equities and derivatives continues to be subdued.

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 part of the OC Group, a boutique investment specialist majority owned by members of its investment team and key executives.

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*
Portfolio Manager, 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 19 years, including the past 5 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

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