Monthly Report
April 2014

Ralton Smaller Companies

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

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 ★★★★ ; Lonsec Investment Grade SMA

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Smaller Companies	-0.08	5.60	17.28	11.71	17.69	6.62
Income Return	0.14	1.28	3.68	3.79	3.81	3.97
Growth Return	-0.22	4.32	13.60	7.93	13.88	2.65
S&P/ASX Small Ords Acc Index	-1.24	2.46	2.06	-4.89	5.78	-3.40
Difference	**1.16**	**3.14**	**15.22**	**16.60**	**11.91**	**10.02**

**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	Sky Network Television Limited	SKT
2	Fletcher Building Limited	FBU
3	Tassal Group Limited	TGR
4	Fisher & Paykel Healthcare Corporation	FPH
5	Beach Energy Limited	BPT
6	Horizon Oil Limited	HZN
7	Invocare Limited	IVC
8	ISelect Limited	ISU
9	Blackmores Limited	BKL
10	Skycity Entertainment Group Limited	SKC

GICS Sector	Ralton	Index	+/-
Financials (ex-Property)	14.5%	6.6%	7.9%
Consumer Staples	7.0%	2.5%	4.5%
Energy	9.3%	4.9%	4.4%
Health Care	7.5%	3.7%	3.8%
Consumer Discretionary	27.6%	23.8%	3.8%
Industrials	17.1%	16.5%	0.6%
Information Technology	2.1%	2.2%	-0.1%
Utilities	0.0%	3.8%	-3.8%
Telecommunication Services	2.8%	8.8%	-6.0%
Property	2.5%	9.6%	-7.1%
Materials	9.6%	17.5%	-7.8%
Total	100.0%	100.0%	

Month in Review

Performance Summary

- The S&P/ASX Small Ordinaries Accumulation Index lost 1.24% for the month, with falls in Healthcare and Information Technology offsetting gains in the Consumer Staples sector.

- Over the same period the Ralton Smaller Companies Portfolio was essentially flat, falling 0.08% for the month and outperforming the benchmark by 1.16%.

- At a sector level, the portfolio's overweight to the Energy and Consumer Discretionary sectors helped to drive outperformance.

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Horizon Oil Ltd	Overweight	Acrux Limited	Overweight
Cash Converters	Overweight	Magellan Financial	Overweight
Tassal Group	Overweight	Goodman Fielder	Overweight

Positive Contribution

Horizon Oil (HZN, +21%) was the portfolio's top performer for April. It was a busy month for HZN. Firstly, in a key milestone for HZN, the PNG government approved the company's gas development for the Stanley project in the West of the country. The approval, including fiscal terms (such as royalties) and land access agreements, paves the way for development of the asset, but also triggers key milestone payments to HZN from one of their Stanley project partners.

This approval in turn prompted corporate development, with HZN and fellow mid-cap oil and gas company ROC Oil (ROC) agreeing to a nil-premium merger. The two companies are currently partners in producing assets in China. If combined the two will become a near $800m market cap company, boasting several producing oil and gas assets and further development options across Asia. At this stage, and having recently met with ROC management, we have a favourable view of the deal, given the scale that it would bring, and in particular the enhanced ability to finance and maintain a significant equity position in the PNG Stanley project. However, as with most mergers, we will watch with interest for any developments, noting that one of ROC's largest shareholders has been voicing his dissent in regards to the deal in the financial press.

Cash Converters (CCV, +15.2%) also boosted portfolio returns. The CCV share price has been steadily recovering off its lows from late last year, when the company announced that trading results in the September quarter were more severely impacted by regulatory changes than the market expected. Despite this we were prepared to back company management. The companys half-year results in December and a further market update in April confirmed loan volumes have continued to improve following the regulatory changes to more normal trading levels.

Sky Network Television operator (SKT, +4.4%), Sky City Entertainment (SKC, +6.3%) and Tassal Group (TGR, +7.4%) each added value to the portfolio in April. SKT is the largest position in the portfolio and on a rolling year basis, the stock is now up 31.6%; furthermore it has moved about 50% higher since the sell-down by News Corporation in March 2013. The strength in the share price is, in our view, representative of the quality of the business and it's monopoly type attributes in the NZ pay TV market, supported by the ongoing strength of the NZ economy.

Negative Contribution

One of our smaller positions, drug delivery technology specialist Acrux (ACR, -40%), was a significant detractor from portfolio performance. Acrux was previously a successful investment for the portfolio, and following a share price fall, the stock came back on to our radar. Driving that weakness, as discussed last quarter, were concerns around US sales trends for the company's testosterone product, Axiron, including recently published medical reports suggestive of negative safety impacts from use of testosterone (not Axiron specific) in older patients. In our view the medical literature is not equivalent to gold standard and is counter to a strong body of medical evidence supporting the use of testosterone in older males. In particular, any concerns around rapid, high dose medication with testosterone would be of more concern for injectible forms of the drug and rather than the more measured release into the body that Axiron achieves.

The US FDA has not taken any material action in regards to testosterone usage and we are further reassured by the fact that use of external testosterone has been a constant in medicine for over 50 years. In February, we saw the stock price reaction as overdone and took a small position in the portfolio. However, first quarter sales trends as reported (post royalties and rebates by marketing partner Eli Lilly) were weaker than expected. This result lead the company to revise their view that a near-term sales milestone, providing for a $50m milestone payment to

Acrux from Eli Lilly, will not be met this year. This last factor was a key driver of the share price weakness in April. Although very disappointing, we see further value at these reduced levels, although we are waiting for near term signs of strengthening sales trends before adjusting our position.

Goodman Fielder (GFF) also detracted from returns, underperforming following a further profit downgrade. Under relatively new management, the company has made strong progress in selling off non-core assets and improving pricing structures with its customers in their key baking division. These savings were however offset in the first half by increased costs to maintain service standards to customers. At that time, GFF explained that network rationalisation across their manufacturing plants had lead to production supply issues, which in turn had forced them to increase costs to meet demand and service standards. Our confidence in GFF was however further dented by another profit downgrade early in April. Although several factors contributed to this latest profit revision, GFF noted that ongoing manufacturing shortfalls had again necessitated additional costs to meet service standards. At this point we sold the stock, having lost faith that management were in control of the business levers.

One of the portfolio's top performers over recent times, Magellan Financial Group (MFG, -8.8%) detracted value in April. The pause in global investment markets, together with some profit-taking, likely contributed toward the weakness. We hold a smaller position in MFG than we did last year, however we still remain supporters of the business model, given the ongoing investment flows that MFG continue to receive. Fellow fund managers Henderson Group (HGG, -4.6%) and diversified financial services company, IOOF Holdings (IFL, -4.2%) also lost ground during April.

Portfolio Adjustments

During the Month we...

SOLD: G8 Education Ltd (GEM), Goodman Fielder Ltd(GFF)

BOUGHT: Equity Trustees Ltd (EQT), Ozforex Group Ltd(OFX)

Purchases

Equity Trustees (EQT) has a strong pedigree in the financial services sector and offers a broad range of services. Their expertise in high barrier to entry areas such as estate planning, private wealth services, and philanthropy, along with their corporate fiduciary services, are key to the appeal of this stock. For example, the company manages various estates and trusts on behalf of individuals or charities. By their nature, these client accounts tend to be long lasting. Although only small, the company recently raised $150m to acquire ANZ Trustees, a similar type of business currently owned by ANZ Banking Group (ANZ). We were not shareholders at the time, and the capital raising created an opportunity to acquire a position in the company. As part of the transaction, EQT expects to derive significant synergies from combining their operations with those of ANZ Trustees.

Ozforex (OFX) is a leader in online international payments. which recently came to market. In a short period, it has built a strong brand, and a reputation as a price leader in the currency conversion market where fees are high and banks have faced limited competitive pressure. We believe the technology platform OFX owns is difficult to replicate and offers potential for geographic expansion and new partnership opportunities. Although the stock is not cheap, following a strong post IPO rally, the recent market weakness in global technology and online stocks created an opportunity to acquire a position in OFX. Assuming the company can execute its strategy we believe the scope for growth in operating profit is attractive.

Disposals

With G8 Education, we have made very strong gains from this stock, both in the last quarter and the last year. Recent sizeable acquisitions by the group, as discussed in our March quarterly report, boosted both the number of childcare centres under management and as a result forecast group profit. The recent share price rally took it beyond our assesed valuation for the company, so we decided to exit the position.

For the reasons outlined above we also disposed of the interest in Goodman Fielder during April.

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

Stephen Evans *B Com, ACA*, Portfolio Manager

Stephen Sedgman Chairman OC Funds Risk Mgt Committee

Robert Frost *B Com, LLB*, Portfolio Manager

Robert Calnon *B Com, ACA*, Portfolio Manager, Equities Dealer

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@ocfunds.com.au

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STANDARD &POOR'S professional planner