Monthly Report February 2014

RALTON ASSET MANAGEMENT

Ralton Australian Shares

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

Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Ralton 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 Australian Shares SMA is to to provide investors with long-term capital growth and some tax effective income from a concentrated portfolio of Australian 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 300 Accumulation Index
Authorised Investments	Companies in the S&P/ASX 300 Index or those amongst the top 300 by size.
Number of Stocks	20-35
Cash Allocation	0% to 10%
Tracking Error	3% to 6%
Investment Horizon	At least 5 years
Ratings	MORNINGSTAR ★★★★; LONSEC Investment Grade SMA; van Eyk

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Aust Shares	3.69	1.01	14.07	9.74	15.88	5.97
Income Return	0.78	0.98	4.34	4.70	4.60	4.54
Growth Return	2.91	0.03	9.74	5.05	11.28	1.43
S&P/ASX 300 Accum. Index	4.92	2.61	10.19	8.22	14.92	3.73
Difference	**-1.23**	**-1.60**	**3.88**	**1.52**	**0.96**	**2.24**

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 significant price fluctuations.

Portfolio Structure

No.	Company Name	ASX Code
1	ANZ Banking Group	ANZ
2	Commonwealth Bank of Australia	CBA
3	BHP Billiton Limited	BHP
4	Westpac Banking Corporation	WBC
5	Telstra Corporation Limited	TLS
6	Oil Search Limited	OSH
7	Amcor Limited	AMC
8	Brambles Limited	BXB
9	Incitec Pivot Limited	IPL
10	Coca-Cola Amatil Limited	CCL

GICS Sector	Ralton	Index	+/-
Industrials	9.7%	6.7%	3.0%
Consumer Discretionary	7.3%	5.0%	2.3%
Telecommunication Services	6.8%	5.1%	1.8%
Information Technology	1.9%	0.9%	1.0%
Materials	19.1%	18.3%	0.8%
Energy	6.1%	5.9%	0.2%
Health Care	3.3%	4.8%	-1.5%
Utilities	0.0%	1.7%	-1.7%
Consumer Staples	6.3%	8.1%	-1.8%
Financials (ex-Property)	35.4%	37.2%	-1.8%
Property	4.0%	6.3%	-2.3%
Total	100.0%	100.0%	

Month in Review

Performance Summary

- The S&P/ASX 300 rebounded strongly in February, gaining 4.92% as all market sectors rose, lead by Consumer Discretionary and Information Techonology.

- For the month, the Ralton Australian Shares Model Portfolio also made strong gains, adding 3.69%, though underperforming the benchmark index by 1.23%.

- The portfolio's lack of exposure to Gold stocks and to a select group of high growth internet stocks detracted significantly from relative performance for the month. Stock selection within Materials, Financials, and Energy however added strongly to portfolio returns for the month.

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Incitec Pivot	Overweight	iSelect Limited	Overweight
QBE Insurance	Overweight	Amcor Limited	Overweight
Oil Search Limited	Overweight	Sims Metal Management	Overweight

QBE Insurance (QBE, +11.6%) was the portfolio's top performing stock for the month, somewhat vindicating our decision to stick with the stock following the December profit downgrade. QBE's FY13 profit result was largely in line with the profit guidance outlined in December, and hence on the basis of 'no further bad news,' the stock staged something of a relief rally. QBE's financial position (balance sheet) is now much improved (the benefit of increased provisioning and profit downgrade) and management are adamant that further profit downgrades such as we experienced in December are now unlikely. We expect QBE will benefit from the cost savings and simplification process that CEO Neal has implemented since coming to the role, and also from rising bond yields boosting profit on their investments. Overall, we continue to have a favourable view of the company's prospects.

Incitec Pivot (IPL, +9.8%) rallied strongly for a second consecutive month, once more buoyed by rising prices for fertilizers (both DAP and UREA) in recent months. As highlighted in our January report, fertilizer prices have been boosted recently by seasonal demand, together with a decline in US inventories and a positive outlook for crop demand across key regions. Ralton's investment in IPL is however based more around the company's explosives (ammonium nitrate) division. Increased production and an increased percentage of profits will come from this division, firstly as the company's Queensland-based Moranbah manufacturing plant ramps up production this year, and secondly when the company's Louisiana ammonia plant, currently under construction, is completed in 2017. In future years, when the fertilizer division contributes only a small portion of group profits and capital expansion has been completed, we expect free cash flow for IPL to rise strongly.

Oil Search (OSH, +7.7%) performed well in February after announcing it will enter the Elk/Antelope gas resource in Papua New Guinea (PNG) via the acquisition of a near 23% interest in the licence area known as PRL 15. Although the deal structure was somewhat complex, the acquisition was essentially funded via a sale of OSH shares to the PNG government at $8.20 per share. To our mind, the deal highlights two features for OSH. Firstly, with OSH's key project, the PNG LNG plant, set to commence gas sales this year, the investment in PRL 15 provides further growth opportunities and potential to expand OSH's LNG interests in PNG. Secondly, it highlights the strong relationship that OSH has with the sovereign government, which is a critical factor in developing projects in such regions.

Other portfolio holdings whose profits were well received by the market included Tassal Group Limited (TGR, +10.6%) and Sky Network Television (SKT, +6.9%). Aristocrat Leisure (ALL, +9.5%) also posted strong gains for the month following positive commentary from management around the profit outlook for the current year.

In a strong market we had several stocks which either treaded water or traded slightly down for the month. This together with some very strong share price movements from a series of high growth stocks that are not held within the portfolio accounted for the bulk of our underperformance in February.

Comparison website provider iSelect (ISU, -21.7%) was the portfolio's worst performer for February. The company reported profit results for the half year to December which were in line with their forecasts, and on this basis, we were somewhat surprised by the share price weakness. Also, the results highlighted improvements in free cash flow, good sales growth in a number of smaller business lines (eg. energy) and a stabilisation in revenue per sale (RPS) for their key healthcare segment. The principal cause of weakness appeared to be lowered expectations for profits in the second half of FY14. The company explained that this was due to both increased investment in data mining capabilities and changes in partner programs which will reduce the upfront commissions payable to ISU. Despite this reinvestment impacting near term profits and further denting shareholder sentiment, we have maintained our investment in ISU as we understand the investment rationale. With the company holding significant cash assets post the IPO and demonstrating good revenue growth, we continue to believe it remains undervalued at these levels. At the time of writing, ISU have just confirmed the appointment of Alex Stevens as CEO. His CV appears impressive and we will likely discuss this development in more detail in our March monthly report.

One of our long-held stocks, Amcor Limited (AMC, -3.8%) also detracted from portfolio returns, falling in outright terms in a strong market. Amcor's half year profit result showed a healthy 20% growth in net profit, however this fell slightly short of the market's expectations, and the stock was sold down. Of note, Amcor experienced a very modest reduction in trading conditions in US beverage markets, although I would highlight that this was only modest and was largely driven by year on year weather impact across the corresponding financial period. Amcor retains very strong industry positions and top quality management, and we consider the company remains on track to produce solid profit growth across their key markets and to deliver strong free cash flow.

A series of our smaller portfolio positions also detracted from performance, including Sims Metal Management (SGM, -6.0%) and Toll Holdings (TOL, -2.6%) which each underperformed following somewhat mixed profit results.

Finally, having no exposure to some of the high growth, high P/E stocks such as Seek Limited (SEK, +37.8%) and Carsales.Com Ltd (CRZ, +17.6%) detracted from relative performance, as did nil exposure to Aurora Oil and Gas (AUT, +53.1%) which benefitted from a takeover bid.

Portfolio Adjustments

During the Month we...

SOLD: Federation Centres, (FDC), Investa Office Fund, (IOF), Twenty-First Century Fox Inc (FOX)

BOUGHT: CSL Limited (CSL), Lend Lease Group (LLC), Macquarie Group, (MQG), National Australia Bank (NAB)

We added four new stocks to the model portfolio during February.

We bought CSL Ltd (CSL) on the basis of ongoing demand for the company's core plasma-derived products. Our sense is that demand for these products, including IVIG, Albumin and a broad range of 'specialty' products, will remain strong. CSL are a top 1 or 2 provider of plasma products across most geographies and continue to demonstrate manufacturing excellence in what is a high barrier to entry, highly regulated segment of the healthcare industry. Dealing with blood products is not taken lightly by the general public! Going forward, the company has a solid pipeline of both novel and follow-on compounds in R&D and overall we have a positive outlook on the company's prospects.

We added a holding in Lend Lease (LLC) where we are attracted to the multi-disciplinary, vertically integrated business model. This allows LLC to make profits across infrastructure, property construction, property ownership and long term property management (typically via investment funds). Although the pipeline of projects (and profits) for LLC out to 2015 has looked solid for some time, recent project wins, together with the likelihood of a rebound in government and private investment in Australia beyond this time frame, has improved our view of likely stock returns. The outlook for LLC's global business operations has also improved. Recent share price weakness provided an opportunity to invest.

We also added a new position in Macquarie Group Limited (MQG) to the portfolio. Since the Global Financial Crisis (GFC), MQG has shifted its business model and profit mix and now receives a far higher percentage of recurring revenue and profits from funds management and recurring commodity trading activities. With a strong balance sheet, MQG is also pursuing growth in the Australian mortgage market, providing genuine competition to the big four banks. Finally, MQG has made good progress in terms of market share for its more transactional focused businesses in the US and ROW markets. With the cycle for mergers and acquisitions appearing to have bottomed, MQG now appears well placed for good growth in both these geographies, and indeed in the Australian market, particularly if the Federal government delivers on its promises of both asset sales and infrastructure development. All of the above gave us confidence to start building a position in MQG.

Price weakness in National Australia Bank (NAB) and the banking sector as a whole was the trigger for adding a position, at what appears a reasonable valuation.

To fund these new purchases we sold our holdings in two of our property holdings, Federation Centres and Investa Office (IOF). Both stocks had narrowed the discount to Net Tangible Assets (NTA) since purchase and hence we felt that better investment opportunities existed.

We also sold the last part of our long held position in Twenty First Century Fox (FOX). As explained last month, this was essentially a forced sale, given the company's announced intention to delist from the ASX.

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)

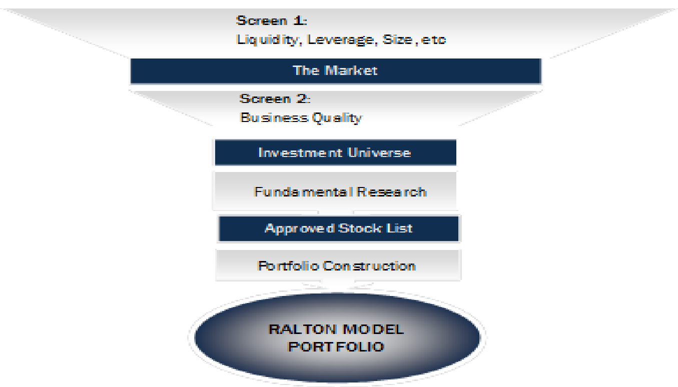
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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

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