RALTON
ASSET MANAGEMENT

Monthly Report February 2014

Ralton High Yield 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 High Yield 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 High Yield Australian Shares SMA is to provide investors with consistent, tax-efficient and growing cash dividend yield, and long-term capital growth. The Portfolio aims to deliver a return superior to that of the market over periods of five years or longer and an above market yield.

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	2% to 5%
Investment Horizon	At least 5 years
Ratings	MORNINGSTAR ★★★★; LONSEC Investment Grade SMA; van Eyk

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton High Yield	3.87	1.74	14.90	11.98	17.08	6.81
Income Return	1.00	1.36	5.41	5.37	5.11	5.14
Growth Return	2.88	0.38	9.48	6.61	11.97	1.67
S&P/ASX 300 Acc. Index	4.92	2.61	10.19	8.22	14.92	3.73
Difference	**-1.05**	**-0.87**	**4.71**	**3.76**	**2.16**	**3.09**

*Since Inception p.a., Feb 2008

The Portfolio is designed for investors who...

- Seek an above market, tax-efficient cash dividend yield and long term capital growth
- 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	Telstra Corporation Limited	TLS
4	Westpac Banking Corporation	WBC
5	BHP Billiton Limited	BHP
6	Woodside Petroleum Limited	WPL
7	Amcor Limited	AMC
8	Sydney Airport	SYD
9	Incitec Pivot Limited	IPL
10	Coca-Cola Amatil Ltd	CCL

GICS Sector	Ralton	Index	+/-
Consumer Discretionary	9.0%	5.0%	4.0%
Telecommunication Services	8.4%	5.1%	3.3%
Industrials	8.6%	6.7%	1.9%
Information Technology	1.9%	0.9%	1.0%
Energy	6.7%	5.9%	0.8%
Utilities	1.7%	1.7%	0.0%
Consumer Staples	6.5%	8.1%	-1.6%
Property	4.5%	6.3%	-1.8%
Health Care	2.6%	4.8%	-2.3%
Materials	15.6%	18.3%	-2.7%
Financials (ex-Property)	34.5%	37.2%	-2.7%
Total	100%	100%	

Month in Review

- The S&P/ASX 300 rebounded strongly in February, gaining 4.92% as all market sectors rose, lead by Consumer Discretionary and Information Techonology
- The Ralton High Yield Model Portfolio also made strong gains, adding 3.87%, underperforming the benchmark index by 1.05%.
- 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. Partially offsetting this, stock selection within Materials and Energy added to portfolio returns for the month.

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
G8 Education Ltd	Overweight	Amcor Limited	Overweight
QBE Insurance Group	Overweight	Goodman Fielder Limited	Overweight
Incitec Pivot Limited	Overweight	SEEK limited	Underweight

G8 Education (GEM, +27.7%) was the portfolio's top performer, driven largely by acquisition activity. The Australian and Singaporean based childcare centre operator added a further 63 centres to its Australian operations in early February, delivering a significant benefit to future year profits. As well as acquisition activity, GEM also delivered strong full year profit results in the February reporting period. The management of G8 have a strong handle on all aspects of the business, providing a quality service but also ensuring that utilisation, staffing levels and overheads (head office) are kept in check. They have an excellent track record in applying these disciplines and systems to newly acquired businesses, together with access to further funding, and we expect GEM to continue to deliver on both an acquisition and operational front.

QBE Insurance (QBE, +11.6%) also performed well 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.

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.

One of our long-held stocks, Amcor Limited (AMC, -3.8%) was the largest negative contributor to portfolio returns, as the stock fell 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.

Goodman Fielder (GFF, -8.1%) had a poor month following a disappointing profit result. Under 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. GFF admitted that network rationalisation across their asset base had lead to supply production issues, which in turn had forced them to increase costs to meet demand and service standards. Goodman Fielder management are now nearly 2 years into a business turnaround that is quite significant. Although we are wary of the danger of turnarounds in this industry sector, we have accepted this backward step as we continue to expect this management team to deliver on their objectives. We continue to have a positive view of the broader agriculture and food thematic, particularly where supported by what we perceive to be competent management.

Coca-Cola Amatil (CCL, -0.5%) and Toll Holdings (TOL, -2.5%) also weighed on portfolio performance. Both reported slightly disappointing half year profit results. Looking forward we expect CCL to benefit from the unwinding of inventory destocking across the industry in CY13, together with a likely decrease in discounting activity from competitors. In Toll Holdings, we continue to expect CEO Brian Kruger to deliver on a number of cost initiatives, some of which were clearly demonstrated in these results, although the tepid economy in Australia continues to pressure Toll's outlook.

In relative terms, 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 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), Sims Metal Management (SGM)

BOUGHT: National Australia Bank (NAB), SkyCity Entertainment Group (SKC)

We added two new stocks to the portfolio, namely SkyCity Entertainment Group (SKC) and National Australia Bank (NAB).

SKC is an entertainment business, focused on hotels, casinos and broader entertainment precincts. The company has interests in key facilities in each of Auckland, Adelaide and Darwin. Broadly speaking SKC is mid-way through a series of upgrades across its portfolio of assets. Once these are complete we believe that revenues and profits should rise due to improved patronage and, critically, that cash flows should also increase as development expense is completed. The stock already pays a very solid yield and we will look for this to increase further once capital expenditure decreases.

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

We also sold two stocks outright from the portfolio, namely Sims Metal Management (SGM) and Federation Centres (FDC).

The outright sale of Federation Centres (FDC), together with a reduced holding in Investa Office Fund (IOF) were part of a broader reduction in our exposure to property stocks. Both stocks had narrowed their discount to net tangible assets (NTA) since acquisition, reducing the value on offer in our opinion.

With Sims Metal Management (SGM) we were disappointed by the lack of dividend payment from the company, and given some share price strength following the first half results, took the opportunity to sell the stock. To add some further detail, the company reported quite reasonable profit results for the December half year, largely meeting market expectations. Of its various geographies, the Australian division reported strong results, the larger US division was weak, and Europe a touch better than expected. In our view, it is only a matter of time until US scrap metal demand improves, in line with the general US economy. Economic growth, and in particular a strong manufacturing sector and improving housing demand drive demand for scrap. In particular, as consumers buy new houses and new cars, this leads to increases in scrap supply from old cars and older household goods (fridges, washing machines) as these are typically recycled. SGM's recently appointed CEO, Mr Galdino Clara, outlined plans for a review of all divisions and a focus on best practice across the group, and although these statements sound somewhat generic, we look forward to hearing the detail in coming months. We will reconsider the stock for this portfolio when conditions in the US improve as expected and we therefore see a return to a more favourable dividend policy, consistent with our portfolio's objectives.

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)

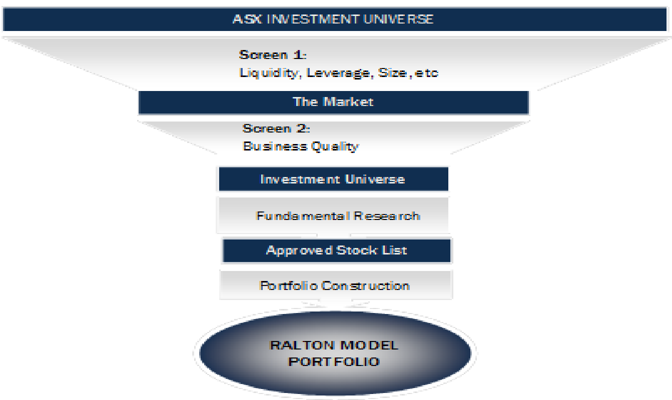
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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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