Monthly Report
February 2014

RALTON
ASSET MANAGEMENT

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	MORNINGSTAR ★★★★

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Leaders	4.08	1.17	12.05	9.34	15.61	5.55
Income Return	0.91	1.12	4.54	4.84	4.63	4.61
Growth Return	3.17	0.04	7.51	4.51	10.98	0.94
S&P/ASX 100 Index	4.91	2.44	11.41	9.49	15.29	4.42
Difference	**-0.83**	**-1.28**	**0.64**	**-0.15**	**0.32**	**1.12**

Since Inception p.a., Feb 2008

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 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	Telstra Corporation Limited	TLS
5	Westpac Banking Corporation	WBC
6	Oil Search Limited	OSH
7	Amcor Limited	AMC
8	Aristocrat Leisure Limited	ALL
9	Incitec Pivot Limited	IPL
10	QBE Insurance Group	QBE

GICS Sector	Ralton	Index	+/-
Information Technology	3.7%	0.8%	2.9%
Energy	7.8%	5.8%	2.0%
Materials	19.7%	18.2%	1.5%
Telecommunication Services	6.3%	5.1%	1.2%
Consumer Discretionary	4.4%	3.1%	1.2%
Industrials	7.2%	6.0%	1.2%
Health Care	6.0%	4.8%	1.2%
Utilities	0.0%	1.7%	-1.7%
Property	3.8%	6.0%	-2.3%
Financials (ex property)	36.4%	39.8%	-3.4%
Consumer Staples	4.7%	8.6%	-3.9%
Total	100.0%	100.0%	

Month in Review

Performance Summary

- The S&P/ASX 100 posted strong gains for February, rising 4.91%, with Consumer Discretionary and Information Techonology the best performing sectors in percentage terms.

- The Ralton Leaders Model Portfolio also recorded strong gains, adding 4.08% for the month, although underperformed the benchmark index by 0.83%.

- 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 and Energy partially offset this, adding to portfolio returns for the month.

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Incitec Pivot Ltd	Overweight	Amcor Limited	Overweight
QBE Insurance Group	Overweight	Sims Metal Management	Overweight
Oil Search Limited	Overweight	Resmed Inc	Overweight

The February reporting season was a key driver of share price performance for the month. Portfolio holdings where profit results and outlook statements were well received by the market included QBE Insurance (QBE, +11.6%), Oil Search (OSH, +7.7%) and Sonic Healthcare (SHL, +6.7%). In relative terms however, 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.

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 profit results were well received by the market included Sonic Healthcare (SHL, +6.7%) and Echo Entertainment (EGP, +12.7%). The latter announced that current CFO, Matt Bekier would replace current CEO, John Redmond, who announced his retirement and intention to return to his native United States.

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.

Sims Metal Management (SGM, -6.0%) reported quite reasonable profit results for the December half year, largely meeting market expectations, and rallied on the day of the result before closing the month lower. Of its various geographies, the Australian division reported strong results, the larger US division was weak, and Europe was 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, in particular a strong manufacturing sector and improving housing demand, drive demand for scrap. 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. Although these statements may sound generic, we look forward to hearing the detail in coming months.

Resmed (RMD, -2.6%) and Toll Holdings (TOL, -2.5%) also weighed on portfolio performance. Both reported half year profit results that somewhat underwhelmed. Looking forward, we expect Resmed to benefit from new product launches and decreased pricing pressure in the key US market. We expect Toll CEO Brian Kruger to deliver on a number of cost initiatives, some of which were clearly demonstrated in these results, although the tepid Australian economy continues to pressure Toll's outlook.

Portfolio Adjustments

During the Month we...

SOLD: Twenty-First Century Fox Inc (FOX)

BOUGHT: Macquarie Group (MQG)

We added to several existing holdings across February, including Aristocrat Leisure (ALL), Brambles Limited (BXB), Orora Limited (ORA) and Recall Holdings (REC).

For ALL and BXB our view is that both companies will benefit from internal initiatives and improving external demand, the latter due to the improving outlook for global growth in Western markets. Each company has spent considerable time and effort improving their business models and competitive positioning in recent years and we believe that this will bear fruit as the cycle turns. Brambles' half year profit result and outlook commentary were well received by the market, as were Aristocrat's somewhat more qualitative comments, made at their AGM during February.

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.

To fund these positions, we sold 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.

We also took some profits in Suncorp Group (SUN), although retain a good holding as we believe that CEO Snowball will continue to drive operational improvements along with paying an attractive dividend.

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)

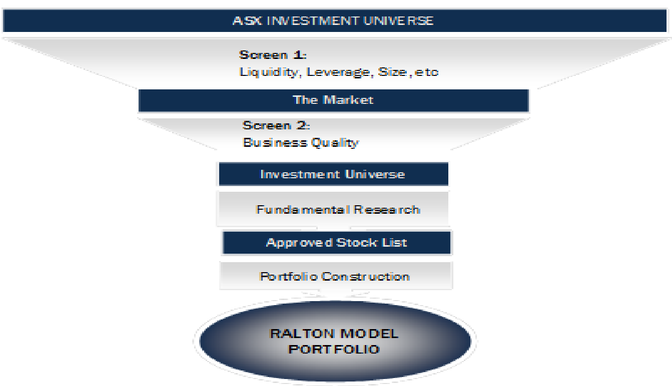
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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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