RALTON ASSET MANAGEMENT

Quarterly Report March 2014

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	1.42	1.93	17.15	10.05	14.52	6.13
Income Return	0.46	1.24	4.30	4.63	4.52	4.56
Growth Return	0.95	0.68	12.84	5.43	10.00	1.57
S&P/ASX 300 Accum. Index	0.21	1.99	12.97	8.05	13.20	3.71
Difference	**1.21**	**-0.06**	**4.18**	**2.00**	**1.32**	**2.42**

**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	Westpac Banking Corporation	WBC
4	BHP Billiton Limited	BHP
5	Telstra Corporation Limited	TLS
6	Oil Search Limited	OSH
7	Amcor Limited	AMC
8	Aristocrat Leisure Limited	ALL
9	Brambles Limited	BXB
10	Incitec Pivot Limited	IPL

GICS Sector	Ralton	Index	+/-
Industrials	11.3%	6.8%	4.5%
Consumer Discretionary	7.8%	4.8%	2.9%
Energy	6.7%	5.8%	0.9%
Telecommunication Services	5.8%	5.1%	0.6%
Materials	17.7%	17.4%	0.2%
Information Technology	0.0%	0.8%	-0.8%
Health Care	3.8%	4.7%	-0.9%
Consumer Staples	6.3%	7.9%	-1.6%
Financials (ex-Property)	36.6%	38.2%	-1.6%
Utilities	0.0%	1.6%	-1.6%
Property	4.1%	6.7%	-2.6%
Total	100.0%	100.0%	

Quarter in Review

Performance Summary

- The S&P/ASX 300 finished the quarter 1.99% higher, with the Utilities and Information Technology sectors offering the strongest percentage gains.
- For the quarter, the Ralton Australian Shares Model Portfolio also made solid gains, adding 1.93%, underperforming the benchmark index by 0.06%.
- At a sector level, the portfolio's overweight exposure to Industrials added value, while our overweight position in Consumer Discretionary detracted.

Portfolio Commentary

Quarterly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Aristocrat Leisure	Overweight	iSelect Limited	Overweight
Orora Limited	Overweight	Treasury Wine Estates	Overweight
Tassal Group	Overweight	Coca-Cola Amatil	Overweight

Materials stocks featured prominently in portfolio returns for the March quarter, with Fletcher Building (FBU, +15.7%) and Orora Limited (ORA, +18.5%) both adding value.

It was pleasing to see strong share price performance by ORA in the first full quarter of the stock trading. The company's maiden half-year profit result in February was reasonably solid. Cost savings from recent plant closures in the Australian division were a highlight of the results. Also, the smaller American packaging division demonstrated strong revenue and profit growth, boosted by the year-on-year decline in the Australian currency and a series of modest contract wins from large US companies. We expect much of Orora's future profit growth will be driven by efficiency gains from the B9 paper mill in Botany. This state-of-the-art plant, currently in ramp-up mode, replaces Amcor's three aging paper mills. Once B9 has been fine-tuned with regard to both the mix of feedstock (various grades of recyclable paper) and operating settings and is running near capacity, the plant is expected to deliver a strong step-up in company profits. ORA has a clean balance sheet containing relatively low debt levels and with cost savings from B9 driving profit growth, we continue to have a favourable view of the stock.

Fletcher Building (FBU) also added value following well-received half-year profit results in February. The ongoing strength of the NZ economy, including residential housing, together with the continued rebuilding of the Christchurch region and cost savings from the 'FBUnite' project, contributed to Fletcher's results.

Smaller portfolio holdings, including recent additions Tassal Group Limited (TGR, +17.3%) and Recall Holdings (REC, +14.5%), the latter having been demerged from Brambles (BXB, +1.2%) last quarter, also added to portfolio returns.

Salmon producer Tassal Group Limited (TGR, +17.3%) had a strong quarter following a well received half-year profit result in February. Although TGR has struggled in previous years, recent profit results have confirmed that the company has turned the corner. Tassal is now benefitting from earlier capital investment, with increased volumes of product (salmon) now driving sales growth in both retail and wholesale markets. In addition to the turnaround that TGR have achieved we also have improved confidence in the outlook for salmon price and volume demand in both the short and medium term. Recent market data suggests that ongoing strong consumption demand for salmon in Australia has now reached the point where Australia is a net importer of salmon. This bodes well for both price and demand. We expect that Tassal, as a well-capitalised, dominant player, will be able to add volumes to the market in a measured manner. TGR's advantage here is not just capital, but also access to additional leases in Macquarie Harbour (Tasmania) and the long lead time between putting young salmon (smolt) to sea and harvesting.

Gaming machine manufacturer Aristocrat Leisure (ALL) also had a strong quarter, adding 14.7%. The main source of news flow was the company's AGM update, where a largely qualitative outlook statement was well received by the market. As we have highlighted previously, ALL is part way through a 5-year turnaround plan under CEO Jamie Odell. Game development takes several years to bear fruit, but it appears that the company's improved product offering is beginning to gain traction amongst buyers. We expect product improvements, together with some improvement in demand, will see Aristocrat deliver reasonable profit growth from this point in the cycle.

Comparison website provider iSelect (ISU, -21.1%) detracted from portfolio returns for the quarter. 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. The results highlighted improvements in free cash flow, good sales growth in a number of smaller business lines (e.g. 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 that will reduce the upfront commissions payable to ISU. Despite this impacting near term profits and 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 is undervalued at these levels. During the quarter the company announced the appointment of Alex Stevens as new CEO. His CV appears impressive, with a history of being CEO or managing director for consumer product segments at Pepsi, Fonterra and Carlton and United Breweries, with roles in US, NZ, Asia and Australia. Interim CEO David Chalmers will return to the role of CFO, and we view the improved management stability as a positive.

Treasury Wine Estates (TWE) also detracted from portfolio performance, following a surprise earnings downgrade by the company in late January. Poor sales outcomes in the final quarter of 2013 drove TWE to downgrade its profit expectations for the full financial year. Specifically, the company cited profit shortfalls in each of Australia and China compared to prior expectations. The Chinese situation was reasonably well understood by the market as being due to the recent crackdown on gift giving and increased austerity measures amongst government entities in China. However, the results in Australia came as a significant surprise and were not sufficiently well explained by the company. In a limited press release, TWE highlighted that their decisions to raise prices and reduce participation in Christmas discounting in the usual manner had impacted Australian sales volumes. For us, this was the final straw as it eroded our confidence in management and the board's ability to achieve good returns for shareholders from what we believe are a reasonable group of assets. Therefore we elected to crystallise a loss on what was a relatively small holding for the portfolio.

Shares in Coca-Cola Amatil (CCL, -8.3%) also detracted from performance following a mixed FY13 profit result, the last from long-time and successful CEO, Terry Davis. Specifically, ongoing discounting in the Australian supermarket sector together with mixed results from the company's Indonesian and PNG operations weighed on profits for the period. Despite this we continue to see the strength of CCL's brand offering, the exposure to the Indonesian growth region, strong free cash flow and the potential for new initiatives from the incoming CEO Alison Watkins as providing a platform for CCL to reverse the profit decline. On a topical note, given the pressure Australia's manufacturing sector has recently faced, we noted that the small but problematic SPC Ardmona (a division of CCL) fruit business received some good news in the quarter, with Woolworths committing to a 5 year contract to purchase fruit from the Victorian based operations.

Finally, having no holding in some high P/E stocks, including SEEK Limted (SEK, +31.0%) and REA Group (REA, +29.1%) also detracted from relative performance.

Portfolio Adjustments

During the Quarter we...

SOLD: Federation Centres, (FDC), Investa Office Fund, (IOF), M2 Group (MTU), Sims Metal Management (SGM), Transpacific Industries Group (TPI), 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 the March quarter.

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.

We also added a new position in Macquarie Group Limited (MQG). Since the Global Financial Crisis, MQG has shifted its business model and profit mix, and now receives a far higher percentage of its recurring revenue and profits from funds management and recurring commodity trading activities. Facilitated by a strong balance sheet, MQG is also pursuing growth in the Australian mortgage market, providing genuine competition to the big four banks. MQG has also made good progress in terms of market share for its more transaction-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 in early February, at what appears a reasonable valuation.

To fund these new purchases we sold our positions in two property stocks, Federation Centres and Investa Office. Both stocks had narrowed their 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). This was essentially a forced sale, given the company's announced intention to delist from the ASX.

Finally we sold out of some of our successful mid-cap investments including the telecommunications company M2 Group (MTU) and Transpacific Industries (TPI). Touching briefly on TPI, the recently announced sale of the company's NZ waste assets for $A880m was well received by the market and continued the deleveraging process that the company has been targeting for several years. However with the asset sales now complete and demand for TPI's services from Industrial clients in Australia still somewhat tepid, we felt that the current P/E multiple did not merit the risk/reward and hence sold our position.

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)

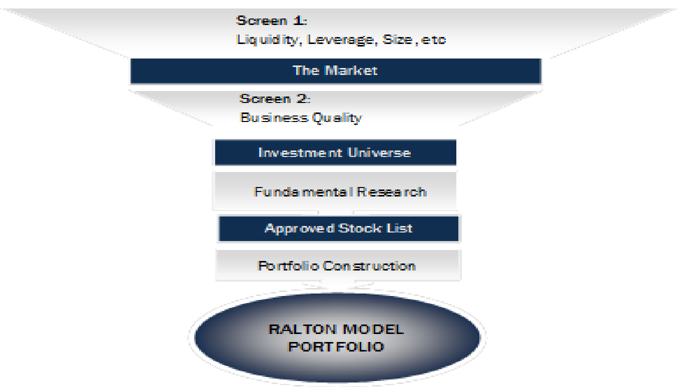
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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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