Quarterly Report March 2014

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 ★★★★

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	QBE Insurance Group	QBE
10	Incitec Pivot Limited	IPL

GICS Sector	Ralton	Index	+/-
Industrials	9.3%	6.0%	3.3%
Energy	7.8%	5.8%	2.0%
Consumer Discretionary	4.6%	3.1%	1.5%
Telecommunication Services	6.4%	5.1%	1.3%
Health Care	5.9%	4.7%	1.2%
Information Technology	1.8%	0.7%	1.2%
Materials	18.1%	17.4%	0.6%
Utilities	0.0%	1.6%	-1.6%
Property	3.9%	6.3%	-2.5%
Financials (ex property)	37.6%	40.8%	-3.2%
Consumer Staples	4.6%	8.3%	-3.7%
Total	100.0%	100.0%	

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Leaders	1.01	1.94	15.39	9.54	13.93	5.64
Income Return	0.34	1.25	4.38	4.73	4.52	4.60
Growth Return	0.67	0.68	11.01	4.81	9.41	1.04
S&P/ASX 100 Index	0.33	2.08	14.26	9.33	13.62	4.42
Difference	**0.68**	**-0.15**	**1.14**	**0.20**	**0.31**	**1.22**

**Since Inception p.a., Feb 2008*

Quarter in Review

Performance Summary

- The S&P/ASX 100 finished the quarter with a solid gain of 2.08%, with Information Technology and Utilities the best performing sectors in percentage terms.
- The Ralton Leaders Model Portfolio also recorded modest gains, adding 1.94% for the quarter, underperforming the benchmark index by 0.14%.
- At a sector level, the portfolio's Materials and Information Technology Sector exposures added value, while being underweight Financials was a negative for relative performance.

Portfolio Commentary

Quarterly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Orora Limited	Overweight	Treasury Wine Estates	Overweight
Aristocrat Leisure	Overweight	ResMed Inc.	Overweight
Fletcher Building	Overweight	Twenty-First Century FOX	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 with cost savings from recent plant closures in the Australian division 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.

Our smaller investment position in 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.

QBE Insurance (QBE, +11.4%) was a solid performer for the quarter, 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.

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.

Treasury Wine Estates (TWE) was the largest detractor 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 surpise 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.

Twenty-First Century Fox (FOX) also detracted from portfolio performance. The stock fell heavily in January after the company announced its intention to consolidate its global share registry and delist from the ASX. Although the consolidation has some merit in that it will align the majority of FOX's investors with the bulk of the company's revenues, we were surprised and disappointed that this development came so soon after the company's mid-2013 demerger. The stock had previously added considerable value to the portfolio, and disappointingly this move by the company made us a forced seller. We sold our position in February, taking advantage of a small rebound in the shareprice following the initial negative reaction to the news.

ResMed Inc. (RMD, -10.4%) and Toll Holdings (TOL, -8.5%) each underperformed following somewhat mixed profit result announcements. For ResMed, the two most recent quarterly profit results have underwhelmed the market and seen the share price retrace some of last year's gains. ResMed's profits are still growing, however pricing pressure in the key US market together with minor loss of market share in the mask segment for OSA products has seen the growth rate slow. With ResMed now poised to launch a series of new products, both masks and devices, in coming months, we have confidence that these trends will reverse.

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: Sims Metal Management (SGM), Treasury Wine Estates (TWE), Twenty-First Century Fox Inc (FOX)

BOUGHT: Macquarie Group (MQG)

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

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.

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 economies. Both have 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 the somewhat more qualitative comments made by Aristocrat at their AGM in February.

To fund these positions, we sold our position in Twenty First Century Fox (FOX) and some less successful investments, including Treasury Wine Estates (noted above) and Sims Metal Management (SGM). As detailed above, the sale of FOX 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 and that the company's dividend policy will continue to support the share price.

RALTON
ASSET MANAGEMENT

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)

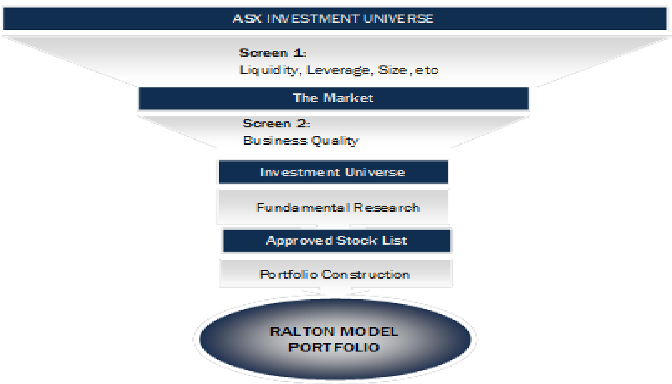
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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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