RALTON
ASSET MANAGEMENT

Monthly Report
July 2014

Ralton Smaller Companies

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

Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Ralton Smaller Companies 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 Smaller Companies SMA is to provide investors with long-term capital growth and some tax effective income from a concentrated portfolio of smaller capitalisation ASX listed 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 Small Ordinaries Accumulation Index
Authorised Investments	ASX listed companies that are not included in the S&P/ASX 50 Index
Number of Stocks	25-40
Cash Allocation	0% to 15%
Tracking Error	5% to 9% per annum
Investment Horizon	At least 5 years
Ratings	MORNINGSTAR ★★★★ LONSEC Investment Grade SMA

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Smaller Companies	2.38	2.59	19.03	14.38	15.55	6.78
Income Return	0.00	0.26	3.42	3.80	3.77	3.86
Growth Return	2.38	2.33	15.61	10.58	11.78	2.92
S&P/ASX Small Ords Acc Index	4.91	3.83	8.07	-1.83	2.64	-2.70
Difference	**-2.53**	**-1.24**	**10.96**	**16.20**	**12.92**	**9.48**

**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 equity markets.

Portfolio Structure

No.	Company Name	ASX Code
1	Fisher & Paykel Healthcare Corporation	FPH
2	Sky Network Television Limited	SKT
3	Fletcher Building Limited	FBU
4	Recall Holdings Limited	REC
5	Tassal Group Limited	TGR
6	Beach Energy Limited	BPT
7	Horizon Oil Limited	HZN
8	ISelect Limited	ISU
9	Village Roadshow Limited	VRL
10	SAI Global Limited	SAI

GICS Sector	Ralton	Index	+/-
Consumer Discretionary	30.3%	22.8%	7.5%
Health Care	9.4%	4.6%	4.8%
Consumer Staples	7.0%	2.4%	4.6%
Financials (ex-Property)	9.3%	6.4%	2.9%
Industrials	17.8%	15.7%	2.1%
Energy	7.2%	5.5%	1.7%
Information Technology	2.8%	2.3%	0.5%
Utilities	1.3%	4.2%	-2.8%
Telecommunication Services	2.9%	8.8%	-5.8%
Property	2.6%	8.5%	-6.0%
Materials	9.4%	18.8%	-9.4%
Total	100.0%	100.0%	

Month in Review

Performance Summary

- The S&P/ASX Small Ordinaries Accumulation Index performed strongly in July, gaining 4.91% for the month, with strength in the Materials and Consumer Discretionary sectors a key feature.

- Over the same period the Ralton Smaller Companies Portfolio added 2.38 %, underperforming the benchmark by 2.53%.

- At a sector level, the portfolio's underweight exposure to Materials, particularly metals and mining stocks, was the key detractor from portfolio performance.

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Acrux Holdings	Overweight	Austbrokers Holdings	Overweight
Recall Holdings	Overweight	Virtus Health Limited	Overweight
iSelect Limited	Overweight	Nufarm Limited	Overweight

Positive Contributors

Specialty pharmaceutical company, Acrux Limited (ACR, +82.6%) recouped recent losses and made a strong contribution to portfolio returns. The catalyst for the share price rebound was an improvement in reported sales by marketing partner Eli Lilly for the company's testosterone replacement therapy drug, Axiron. The rebound in reported sales was pleasing, and we believe that the full value of the Axiron franchise for ACR remains undervalued. However we would still flag that the market for testosterone products in the US remains in flux. In fact the improvement in reported sales was more reflective of a stabilization of prescription trends in recent periods. On this basis we took the opportunity to take recent profits in ACR, although remain invested.

Document and information management company Recall Holdings (REC, +8.0%) was the portfolio's top contributor for July. Late in June, REC announced a Facility Optimisation Program (i.e. productivity improvements), designed to decrease costs and increase utilization across their global storage facilities. Essentially, REC will be fine-tuning their real estate footprint and boosting storage density at their remaining facilities. The company's plan is to achieve $11m in cost savings over the next 18 months. Our investment in Recall is based on its existing annuity-type revenue streams and the opportunity focused management (post demerger from BXB) have to continue to grow the business through productivity improvements and selective acquisitions. We consider there is a huge opportunity for REC to make bolt-on acquisitions given its global footprint and the changing global regulatory environment making it harder for small players. We continue to view REC as a stable business with strong market positions and an outlook for reasonably steady organic and acquisition growth.

Online comparison service provider, iSelect Ltd (ISU, +7.4%) was a positive contributor to portfolio returns. After a high profile IPO that disappointed investors and lead, in part, to the resignation of the CEO, ISU appears to be back on track. The appointment of well credentialed CEO, Alex Stevens, the acquisition of Energy Watch, and what we understand to be strong lead generation in the Utilities/ Energy segment have helped to restore investor faith in ISU and bring the stock back onto investors' radar. Meeting expectations at the upcoming FY14 results would help to further rebuild the company's image and hence we look forward to confirmation of the company's profit targets in August.

Negative Contributors

Insurance broker, Austbrokers Holdings (AUB, -7.3%) was weak in a strong market, likely impacted by concerns that underlying insurance premiums are no longer growing at the same level as in recent years. AUB has ownership stakes in a network of insurance brokers across Australia offering a range of insurance services to their clients, largely SME type businesses. AUB insurance brokers achieve a commission on insurance premiums and hence there is a potential impact on their business from the overall insurance cycle. AUB have a strong track record of profit growth, year in, year out, with growth in premiums and overall service provision augmented by the acquisition of stakes in more insurance brokers. Already in FY15 we have seen AUB make two material acquisitions, and hence we expect that AUB is capable of delivering relatively sound profit growth through the cycle.

Virtus Health Limited (VRT, -3.8%) also lost ground in a strong market. The IVF provider has performed well since the IPO in mid 2013, rising 40.1% from the $5.60 issue price. Concerns in the press and government about the inability to pass legislation relating to co-payments for GPs and pathologists has lead to some concerns over funding for all commonwealth funded medical services. For your typical IVF treatment, government funding is about 40-45% and clearly contributes to the affordability of the procedure. The listing of Monash IVF Group (MVF) in late June also likely weighed on the share price. VRT has recently increased it's presence in offshore markets, with the acquisition of a key clinic in Ireland and the opening of a new facility with established IVF doctors in Singapore. We see VRT's intellectual property as very strong in this space and remain supportive of the offshore expansion.

Global agriculture company Nufarm (NUF, -6.5%) gave up recent gains and detracted from portfolio returns for the month. Nufarm has operations across most continents and it appears that the recent deep freeze in North America is likely weighing on the company's near term profit outlook in this region. The deep freeze and late thaw has delayed spring crop planting and subsequent need for crop protection products. Nufarm also have significant exposure to lawn products in the US and no doubt this segment has also been impacted. At the upcoming results presentation, we are confident that Nufarm will confirm the recent strong performance of the business in South America, improved trading conditions in Australia, and importantly a reduction of group debt. On a portfolio basis, we continue to view NUF as well placed to continue to grow its operations across a diverse geography, noting that the vagaries of agriculture will always be present.

Portfolio Adjustments

During the Month we...

SOLD:

BOUGHT:

Portfolio Disposals & Material Adjustments

There were no outright sales during the month, with the only transaction being a reduction in our ACR position as flagged in earlier commentary.

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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