Monthly Report July 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	

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 equity markets.

Portfolio Structure

No.	Company Name	ASX Code
1	Commonwealth Bank of Australia	CBA
2	BHP Billiton Limited	BHP
3	Telstra Corporation Limited	TLS
4	ANZ Banking Group	ANZ
5	National Australia Bank Limited	NAB
6	Westpac Banking Corporation	WBC
7	Oil Search Limited	OSH
8	Aristocrat Leisure Limited	ALL
9	QBE Insurance Group	QBE
10	Amcor Limited	AMC

GICS Sector	Ralton	Index	+/-
Industrials	12.3%	6.4%	5.9%
Health Care	7.8%	4.8%	3.0%
Consumer Discretionary	6.1%	3.5%	2.6%
Telecommunication Services	7.5%	5.0%	2.5%
Information Technology	1.9%	0.7%	1.1%
Energy	7.1%	6.8%	0.3%
Materials	15.5%	17.1%	-1.6%
Utilities	0.0%	1.8%	-1.8%
Financials (ex-Property)	36.3%	38.8%	-2.5%
Property	2.7%	6.9%	-4.2%
Consumer Staples	2.8%	8.2%	-5.3%
Total	100.0%	100.0%	

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Leaders	3.31	3.76	16.23	14.95	11.16	6.20
Income Return	0.00	0.64	4.05	4.43	4.34	4.46
Growth Return	3.31	3.12	12.18	10.52	6.81	1.74
S&P/ASX 100 Index	4.37	3.54	16.99	14.43	11.04	5.05
Difference	**-1.06**	**0.21**	**-0.76**	**0.53**	**0.12**	**1.14**

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

RALTON ASSET MANAGEMENT

Month in Review

Performance Summary

- The S&P/ASX 100 accumulation index added 4.37% for the month, with Materials and Information Technology the top performing sectors.
- The Ralton Leaders Model Portfolio recorded a solid gain of 3.31% for the month, underperforming the benchmark index by 1.06%.
- Although the portfolio made a positive return, our underweight exposure to both Materials and select Industrials detracted from relative returns and lead to the portfolio underperforming the benchmark.

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Recall Holdings	Overweight	Rio Tinto	Underweight
Aristocrat Leisure	Overweight	Amcor Limited	Overweight
Echo Entertainment	Overweight	Oil Search Limited	Overweight

The market rose strongly in July, and although the portfolio gained 3.31%, it underperformed the benchmark by 1.06%. The key reason for this underperformance was the portfolio's underweight exposure to both metals and mining (resource) stocks and, to a lesser degree, several 'China facing' industrial stocks. Iron ore focused miner, Rio Tinto (+11.9%), Alumina Limited (AWC, +18.9%), BlueScope Steel (BSL, +15.9%) and Orica Limited (ORI, +12.9%) were all not held by the portfolio and therefore detracted from relative returns.

Regular readers will understand our cautious views on the Chinese economy as it seeks to rebalance from a fixed asset investment and export driven growth model to a domestic consumption driven growth model. This means slowing demand growth for commodities in future years just as the major miners are delivering massive supply increases to the market. Whilst this analysis has proven largely correct in recent years, short-term improvements in several Chinese economic indicators fuelled the performance of this segment of the market in July. We are sticking to our view that China will need to address the imbalance in their economy in the next couple of years, and as such, we believe there are better opportunities for us to invest in companies with less direct exposure to the Chinese economy.

Positive Contributors

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.

Aristocrat Leisure (ALL, +8.4%) shares were boosted by the acquisition of US-based Video Gaming Technologies (VGT) for US$1.28bn. VGT operate in a different space to ALL's existing gaming machine business and VGT has the benefit of having all its revenue come from participation contracts (i.e. annuity style revenue stream whereby VGT shares in the profit from the machine). The acquisition appears to have been made at an attractive price given other recent gaming transactions. We remain attracted to the progress being made by ALL under CEO Jamie Odell's 5-year turnaround plan. ALL have invested heavily in new product to improve the quality of their gaming offering. ALL also has "blue sky" upside from the rise of mobile gaming (i.e. via Facebook and other mobile sites). There is no online gambling, as such, but people pay small amounts for changes to the screen or play experience (e.g. $0.10 for a new screen). It seems weird to us, but if people are going to spend money to play these games on their mobiles, who are we to argue!

Echo Entertainment's (EGP, +6.4%) recent strong share price performance continued into July, following the FY14 profit upgrade in June. Underpinning the profit upgrade were strong revenue growth at EGP's QLD and NSW casino operations across the current half-year and the continued tight management of operating costs. In particular, investors were reassured that EGP's main asset, Star Casino in Sydney, has finally begun to deliver consistent returns following the major refurbishment a few years ago. EGP has partnered with Chow Thai Fook Enterprises (CTF) and Far East Consortium (FEC) to form the 'Destination

Brisbane Consortium' to bid for the new Brisbane casino. The participation in the new casino via a consortium should make the capital commitment required more manageable for EGP. Submissions are due by late 2014 with the QLD government targeting a decision early in 2015. The consortium arrangement makes this a more attractive proposition in our view.

Negative Contributors

Rio Tinto (RIO, +11.9%) was the key detractor from portfolio performance for the month as we did not have a position in the stock. The relatively new management team of Sam Walsh (CEO) and Chris Lynch (CFO) have performed well since taking the reigns in early 2013. Operational cost targets have been met, capital expenditure has been reduced and debt metrics improved in turn. The legacy of prior management still exists however, as evidenced by the recent sale of RIO's Riversdale Mining (Mozambique) coal operations for some \$53m, a far lower figure than the \$3.9bn paid for the assets at the height of the boom. Ralton has not owned shares in RIO for some time due its substantial exposure to iron ore demand and price risk. As a best case scenario, iron ore prices will continue to drift lower given rising global supply (particularly from Australian majors BHP, RIO, FMG). As a worst case, the iron ore price could fall relatively quickly if China has a more serious property slow down. The global market is likely to continue to absorb all the iron ore RIO produces, it is just the pace and extent of the price decline which is in question. We continue to monitor RIO and will re-enter the stock if we see these risks reflected in the share price.

PNG-focused energy company Oil Search Ltd (OSH, -2.0%) gave up some of their recent gains and detracted from performance in a strong market. A 6% fall in the oil price in July certainly contributed to the relative weakness across the Energy sector. This has not changed our investment thesis for OSH. OSH shipped the first gas to customers in Japan from their flagship PNG LNG gas plant, train 1, during May. OSH and plant operator Exxon Mobil have since confirmed that ramp up of first gas from the second LNG train is running ahead of schedule. For OSH the absolute dollars generated will be transformational, allowing scope for the company to increase dividends to shareholders and likely invest in further LNG gas trains in PNG (up to another three by 2020 are possible). We expect clarification on expansion programs, including drilling results and progress toward feasibility studies, across the balance of 2014 and calendar year 2015.

Amcor Limited (AMC, 0.0%) finished flat for the month of July and, given the strong market, contributed to our relative underperformance. We have held the stock for many years, prior to the large, transformational acquisitions of both Alcan and Ball Packaging, and have witnessed management deliver on a series of cost and operational targets as well as pursue their drive to consolidate and rationalise their industry and markets. Late in the month Amcor announced the introduction of a revolutionary 'liquiform technology' designed to reduce both cost and manufacturing steps in production of Amcor's RPCs (rigid plastic containers). Together with joint venture partner Sidel we expect AMC to license, commercialise and manufacture this technology. Amcor's intellectual property in the packaging space is considerable and a key differentiator with global customers when it comes to choice of packaging partner in emerging markets.

Portfolio Adjustments

During the Month we...

SOLD: Woodside Petroleum Limited (WPL)

BOUGHT: Transurban Group (TCL)

Portfolio Additions & Material Adjustments

Transurban Group (TCL) was a new addition to the portfolio in July. TCL own a portfolio of toll roads concentrated across the eastern seaboard of Australia. The assets are high quality, largely intra-urban roads with strong volume growth from demographic changes and essentially mandated annual fee rises for road users across the life of the asset or concession period. The combination of population driven volume increase in traffic plus annual price hikes (set into the concession deeds) gives strong ongoing growth in free cash flow for TCL, and hence, growth in dividends to its investors. The recent acquisition of the Queensland-based QML road network appears to be a solid, long-term investment. The capital raising associated with the QML acquisition provided a depressed price at which we acquired the position.

We made a significant increase in our National Australia Bank (NAB) holding in July. Although NAB has been our least preferred bank, two recent developments renewed our interest in the stock. Firstly, new CEO Andrew Thorburn (replacing Cameron Clyne) is an experienced banker who achieved encouraging cultural change in the NZ operations - something we believe is essential to improve the Australian operations. Secondly, the improvement in the outlook for the UK should mean the bank can divest its legacy UK commercial property loan portfolio and potentially divest its interest in Clydesdale Bank. During the month the bank sold a £625mn parcel of UK commercial real estate loans at above book value to an affiliate of Cerberus Global Investors. This was a good start, although there is still some way to go on this legacy book. This potential for change and the discount at which NAB trades relative to its peers gave us more confidence to increase our position.

Portfolio Disposals & Material Adjustments

The increase in our NAB holding was funded by a reduction in our positions for each of ANZ Banking Group (ANZ) and Westpac Banking Corporation (WBC), leaving our exposure to the sector as a whole unchanged.

The only outright stock sale for the month was Woodside Petroleum (WPL). Australia's largest oil and gas company has been a pioneer in the Australian LNG market and now boasts two large cash flow producing assets in the Pluto LNG asset and NW Shelf asset. Despite these achievements and being cash rich – which supports WPL's current dividend yield payouts - WPL is lacking in growth projects. The high cost of developing projects in the Australian region has seen the massive Browse project deferred and attention directed toward a new offshore floating LNG rig technology. Given the exposure to Origin and Oil Search in the portfolio, we decided to exit the investment.

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)

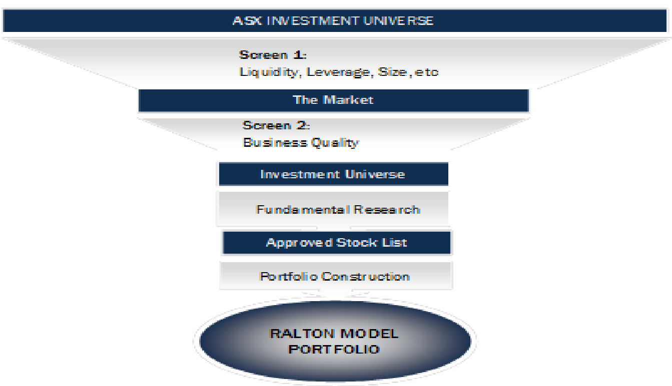
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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

Stephen Sedgman Chairman OC Funds Risk Mgt Committee

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For Further Information

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