RALTON
ASSET MANAGEMENT

Quarterly Report June 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	-0.98	1.68	18.25	12.36	12.79	6.16
Income Return	0.19	0.69	4.02	4.64	4.47	4.49
Growth Return	-1.17	0.99	14.23	7.72	8.33	1.67
S&P/ASX 300 Accum. Index	-1.45	0.86	17.25	9.95	10.95	3.70
Difference	**0.47**	**0.82**	**1.00**	**2.41**	**1.84**	**2.46**

**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	Commonwealth Bank of Australia	CBA
2	ANZ Banking Group	ANZ
3	Westpac Banking Corporation	WBC
4	BHP Billiton Limited	BHP
5	Telstra Corporation Limited	TLS
6	Oil Search Limited	OSH
7	Origin Energy Limited	ORG
8	Amcor Limited	AMC
9	QBE Insurance Group Limited	QBE
10	Recall Holdings Limited	REC

GICS Sector	Ralton	Index	+/-
Industrials	13.5%	7.0%	6.5%
Consumer Discretionary	7.7%	4.2%	3.5%
Energy	7.7%	6.0%	1.7%
Health Care	6.1%	4.7%	1.4%
Telecommunication Services	5.8%	5.3%	0.5%
Materials	16.9%	16.9%	0.0%
Information Technology	0.0%	0.8%	-0.8%
Utilities	0.0%	1.7%	-1.7%
Property	4.3%	7.1%	-2.7%
Consumer Staples	4.6%	8.2%	-3.5%
Financials (ex-Property)	33.3%	38.0%	-4.8%
Total	100.0%	100.0%	

Quarter in Review

Performance Summary

- The S&P/ASX 300 accumulation index added 0.86% for the quarter, with Energy and Utilities the top performing sectors.
- For the quarter, the Ralton Australian Shares Model Portfolio returned 1.68%, outperforming the benchmark index by 0.82%.
- At a sector level, the portfolio's overweight exposure to both the Healthcare and Energy sectors added value, offset by our underweight exposure to Financials.

Portfolio Commentary

Quarterly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
ResMed Inc	Overweight	QBE Insurance Group	Overweight
Oil Search Ltd	Overweight	Chandler Macleod Group	Overweight
Cash Converters International	Overweight	Coca-Cola Amatil	Overweight

Positive Contribution

ResMed Inc. (RMD, +15.9%) was a strong contributor to the portfolio in the June quarter. The company's third quarter profit result delivered 8% growth in earnings per share (EPS) and was well received by the market. Critically, the US region, which accounts for about 55% of company sales, demonstrated an improving sales trend for both masks and breathing devices compared to recent quarters and, perhaps, the market's overall expectations. The result and management commentary strongly suggest that recent disruptions caused by changes in pricing and consolidation of service providers (known as DME's) in the US were abating and that 'business as usual' was returning. Reimbursement pressures are a constant in healthcare as government and private payors seek ways to offset the rising cost of providing services. Despite this, RMD is well placed to grow its service offering, through ongoing penetration of the patient population for sleep apnea and expanding services. RMD is expanding its clinical offering, with full launch of the Astral 150 in Europe later this year, targeting the market for invasive and non-invasive life support ventilation for both adult and paediatric patients. This launch together with new product initiatives and a likely whole new platform offering in their sleep apnea segment should, in our opinion, drive solid revenue growth and support our investment in ResMed.

Oil Search (OSH, +15.7%) was boosted by the shipment of first gas to customers in Japan from the company's 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 and should commence mid-year. Early commissioning means an earlier path to cash flows for all of PNG LNG's owners. For OSH the dollar amounts 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). OSH recently acquired a material interest in another PNG gas field, named Elk/ Antelope (or PRL15). This field, co-owned by Total and InterOil, will likely be used to support some of the additional LNG trains. The size and nature of any future LNG trains will be determined by further field (exploration) works, together with negotiations between the joint owners of Elk/Antelope and the PNG government. We expect clarification on this front across the balance of 2014.

Cash Converters International (CCV, +12.5%) was also a strong contributor to performance during the quarter. The CCV share price has been steadily recovering off it's lows late last year, when the company announced that trading results in the September quarter were well below expectations. At the time the company highlighted the impact on customer behaviour from new regulatory requirements for CCV's loan products. Despite this, we were prepared to back company management, who at the time flagged that conditions were expected to improve beyond this period. Pleasingly, the company's half-year results in December and a further market update in April confirmed that recent periods have seen a continued improvement and rebound toward normal trading. CCV management continue to improve their systems and service offering, with improvements in the online customer offering continuing to grow the customer base. Future growth will also come from expansion in Cash Converter stores, both in Australia and New Zealand.

Negative Contribution

QBE Insurance Group (QBE, -15.2%) was the largest detractor from portfolio performance. Contributing to the weakness was the ongoing strength of the Australian dollar, which of course impacts translation of US dollar profits, together with some weakening in key government bond yields, which impacts QBE's investment returns and value of its liabilities. In the short term it appears that bond investors are tempering their view of the US growth outlook following a severe winter that has weakened economic activity in the US. QBE also announced a 'strategic review'' of its US middle market business at its AGM in April. This will likely see the company sell and exit some aspects of the business in the US, and overall was not a material surprise in our view. In June, the company announced the merger of its Asia Pacific and Latin American businesses to form an emerging markets division, effective August 2014. We view this development positively, given the positive growth outlook for these regions in years to come and the need for QBE to ensure a dedicated focus.

Recruitment services company Chandler Macleod (CMG, -20.5%) also detracted from performance across the quarter. The company issued a profit downgrade citing a softening of business confidence in recent months, which related to the persistently high Australian dollar and the potential negative impact of the May budget. Demand for CMG's blue collar workers has been improving, while results in CMG's physiotherapy placement service Vivir and hotel outsourcing business have been in line with company forecasts. However, demand for white collar workers has been below expectations. Overall the mix of outcomes will see CMG fall short of the expected level of profit growth for the financial year. Although disappointed, we expect that CMG will continue to grow profits, particularly through internal initiatives, provided that the overall economic environment does not deteriorate markedly. Well regarded CFO Owen Wilson also resigned late in the quarter having accepted the same role at the much larger REA Group (REA). At the portfolio level we took the decision to further reduce our exposure to domestic cyclical stocks and sold CMG at a loss.

Coca-Cola (CCL, -14.2%) also detracted from portfolio performance during the quarter, although most of the stock price fall came after we had significantly reduced the weight in the portfolio in early April. CCL has been facing substantial headwinds over the past couple of years. These related to increased competition from a Japanese controlled competitor (lacking profit discipline), de-stocking by the major supermarkets, a soft consumer environment and cost headwinds in Indonesia arising from a decline in the value of the rupiah and a rise in the minimum wage. In addition, there are rising health concerns about the level of sugar consumption (i.e. is this the next tobacco?). At the time we acquired the initial holding we were of the view a number of these headwinds would ease in CY14, and that it will be a long time before health concerns significantly dent consumption. We reduced our holding in early April after re-visiting our thesis around the timing of a recovery in a number of these areas. Later in the month, new CEO Alison Watkins surprised us with a dramatic downgrade in current year earnings expectations. We are of the view some of this is a re-basing of earnings to give the new CEO room to manoeuvre in making some structural changes in the company. At another level, there is a recognition that the competition from Schweppes, the soft domestic consumer environment and the Indonesian pressures will persist in the short-term. We are still a fan of the products CCL produces, the financial returns it has generated over a long period of time, and the growth options presented by Indonesia, and expect it will get back on the path of profit growth in coming periods. So we will continue to monitor the progress of Alison Watkins as she conducts a restructure of the operations with a view to adjusting the portfolio position further at an appropriate time.

Portfolio Adjustments

During the Quarter we...

SOLD: ASX Limited (ASX), Toll Holdings (TOL)

BOUGHT: Transpacific Industries Group (TPI), Transurban Group (TCL)

Purchases/Additions

Transurban Group (TCL) was a new addition to the portfolio in May. TCL own a portfolio of high quality 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 GDP driven volume increase in traffic load plus annual price hikes 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 revisited a previously successful investment, adding a position in Transpacific Industries (TPI) in June. The stock's progress had seen the company enter the Top 100 index of Australian companies and as is sometimes the case, this triggered share price weakness as 'Small Cap' managers became forced sellers of the stock. Since we last held the stock in the portfolio the sale of the NZ Waste business has been completed and hence new CEO Robert Boucher has taken the reins of a debt-free business. As such TPI management can finally focus all its energies on running the business more efficiently and seeking avenues through which to grow. We expect to see revived sales strategies to acquire new customers, improving route density across their waste collection network. The new CEO has also flagged his intention to acquire, either outright or in partnership with others, ownership in landfills. By owning the landfill, TPI will be able to capture the profits across a greater portion of the waste value chain. Although the Australian east coast economy continues to face headwinds, we believe that over the long term waste production and therefore services should grow at rates at or above GDP, and hence be supportive of our investment in TPI.

Disposals

There were two outright stock sales for the quarter, with both ASX Ltd (ASX) and Toll Holdings (TOL) sold from the portfolio. Although Toll continues to deliver on a series of cost out initiatives, our analysis indicates that headwinds across a number of Toll's service offerings remain. In particular, domestic customers continue to seek lower cost service offerings for their transport requirements as part of their own cost saving initiatives. In addition, Toll's operations in both the Asian region and resource segment continue to face margin pressures and risk from contract renewals. On balance, we have elected to sell our position in Toll, with the proceeds invested in TPI.

The other stock sale for the quarter was ASX Ltd (ASX), with most of the proceeds used to increase the investment in Macquarie Group Limited (MQG). Whilst we still like the ASX business model, the company does face some headwinds given that volume growth for equities and derivatives continue to be subdued.

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)

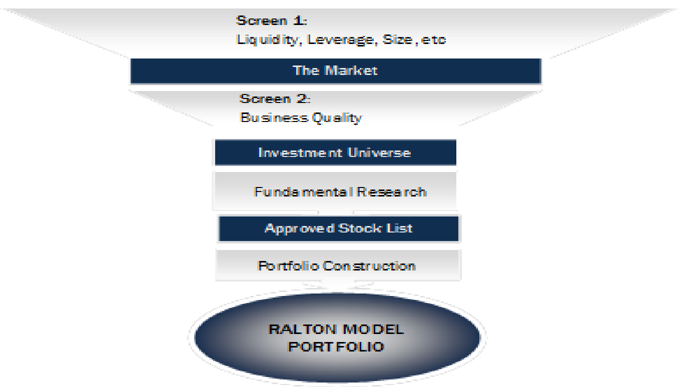
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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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