Quarterly Report
June 2014

Ralton High Yield 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 High Yield 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 High Yield Australian Shares SMA is to provide investors with consistent, tax-efficient and growing cash dividend yield, and long-term capital growth. The Portfolio aims to deliver a return superior to that of the market over periods of five years or longer and an above market yield.

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	2% to 5%
Investment Horizon	At least 5 years
Ratings	

The Portfolio is designed for investors who...

- Seek an above market, tax-efficient cash dividend yield and long term capital growth
- 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	Telstra Corporation Limited	TLS
3	ANZ Banking Group	ANZ
4	Westpac Banking Corporation	WBC
5	BHP Billiton Limited	BHP
6	Origin Energy Limited	ORG
7	Woodside Petroleum Limited	WPL
8	Amcor Limited	AMC
9	Recall Holdings Limited	REC
10	Sonic Healthcare Limited	SHL

GICS Sector	Ralton	Index	+/-
Industrials	12.3%	6.9%	5.4%
Consumer Discretionary	7.8%	4.2%	3.6%
Energy	8.4%	6.3%	2.1%
Health Care	6.1%	4.6%	1.5%
Telecommunication Services	5.7%	5.2%	0.5%
Materials	17.0%	16.9%	0.1%
Information Technology	0.0%	0.8%	-0.8%
Utilities	0.0%	1.8%	-1.8%
Property	4.3%	7.1%	-2.8%
Consumer Staples	4.6%	7.9%	-3.3%
Financials (ex-Property)	33.8%	38.2%	-4.4%
Total	100%	100%	

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton High Yield	-1.14	1.17	18.37	14.34	13.86	6.87
Income Return	0.31	0.81	4.83	5.31	5.01	5.08
Growth Return	-1.45	0.36	13.53	9.03	8.84	1.79
S&P/ASX 300 Acc. Index	-1.45	0.86	17.25	9.95	10.95	3.70
Difference	**0.31**	**0.31**	**1.11**	**4.39**	**2.90**	**3.17**

Since Inception p.a., Feb 2008

RALTON ASSET MANAGEMENT

Quarter in Review

- The S&P/ASX 300 accumulation index added 0.86% for the quarter, with Energy and Utilities the top performing sectors.
- The Ralton High Yield Model Portfolio returned 1.17% for the quarter, outperforming the benchmark index by 0.31%.
- At a sector level, stock selection within both Materials and Utilities added value to the portfolio, offset to some degree by our underweight exposure to Financials.

Portfolio Commentary

Quarterly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Duet Group	Overweight	QBE Insurance Group	Overweight
Sky Network Television	Overweight	Goodman Fielder Ltd	Overweight
Village Roadshow Ltd	Overweight	Chandler Macleod Group	Overweight

Positive Contribution

Duet Energy (DUE, +16.4%) added to the portfolio's return as bond yields continued to decline and the market speculated about a potential merger. Specifically, Spark Infrastructure Group (SKI) acquired a 14.1% interest in DUE during May at an average entry price of $2.16. DUE own a series of investments, including majority ownership in the Dampier to Bunbury pipeline, the premier gas pipeline in Western Australia. In isolation, the rationale behind SKI taking a minority stake in DUE is not clear, however, it is apparent that they are positioning themselves for any future corporate activity in the sector. DUE also provided distribution (DPS) guidance in June for the coming financial year of 17.5c/security, which was slightly ahead of the market's expectations and this was well received by investors.

NZ based Sky Network Television operator (SKT, +8.3%) also added value across the quarter. Rolling year the stock is now up 39.6% and furthermore has moved about 50% higher since the sell down by News Corporation (now Twenty-First Century FOX) from the register in March 2013. The strength in the share price is, in our view, representative of the quality of the business and it's monopoly-type attributes in the NZ pay TV market, supported by the ongoing strength of the NZ economy.

Fellow entertainment company, Village Roadshow (VRL, +7.7%) continued to increase in value. Rolling-year to the end of June the share price is now up 36.8%. We consider the strength in the share price reflects the quality of the assets that VRL own, namely cinemas, film distribution rights, and entertainment parks, mostly in Australia but with several modest sized operations elsewhere. Historical issues around debt levels and corporate governance had kept VRL out of our investment universe, however, substantial improvements on this front bought the company onto our investment radar. VRL successfully built and opened a large scale water park in western Sydney last summer, tapping into a market ripe for an entertainment product of this type and applying one of its successful concepts in a new market. Investment team members have been waiting to try it out, but the crowds have kept them away from the slide so far!

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.

Goodman Fielder (GFF) was sold from the portfolio in early April, following a further profit downgrade. Under relatively new management, the company has made strong progress in selling off non-core assets and improving pricing structures with its customers in their key baking division. These savings were however offset in the first half by increased costs to maintain service standards to customers. GFF explained that network rationalisation across their manufacturing plants had lead to production supply issues, which in turn had forced them to increase costs to meet demand and service standards. Our confidence in GFF was however further dented by another profit downgrade early in April. Although several factors contributed to this latest profit revision, GFF noted that ongoing manufacturing shortfalls had again necessitated additional costs to meet service standards. At this point we sold the stock, having lost faith that management were suitably in control of the necessary business levers.

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). We will continue to monitor the economic environment closely as risks are currently skewed to the downside.

Portfolio Adjustments

During the Quarter we...

SOLD: ASX Ltd (ASX), G8 Education (GEM), Goodman Fielder (GFF), Toll Holdings (TOL)

BOUGHT: Lend Lease Group (LLC), Macquarie Group Limited (MQG), Transurban Group (TCL)

Purchases

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 also added a position in Lend Lease (LLC), where we are attracted to the multi-disciplinary, vertically integrated business model. This allows LLC to make profits across construction, development, direct asset 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 timeframe, has strengthened our conviction around the length of this cycle. The outlook for LLC's global business operations has also improved and could well provide the next avenue for growth. Late in the quarter, LLC sold its investment in UK's Bluewater Shopping Centre for $1.2bn, netting a profit to Lend Lease of $480m post costs and taxes. Bluewater would dwarf most Australian shopping centres, such as Chadstone or Chatswood. For Lend Lease it is further confirmation of their ability to deliver profits from asset recycling.

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 earnings from annuity type businesses such as funds management. However the earnings from the more transactional business of FICC, investment banking and securities have continued to be a drag. We are now seeing signs of life for investment banking in the US and Asia with good volume lifts in the last half. Further, the pending sales by state governments of infrastructure assets should provide a string of opportunities in the Australian market. Finally, the wind down of US Fed QE3 should see a rise in volatility globally which can be a positive for FICC businesses.

Disposals

Four stocks were sold during the quarter, namely ASX Ltd (ASX), G8 Education (GEM), Toll Holdings (TOL) and GFF, the last of which we have already discussed.

With G8 Education (GEM) we have made very strong gains from this stock both in the last quarter and the last year. Recent sizeable acquisition by the group, as discussed in our March quarterly report, boosted the number of childcare centres under management and, as a result, forecast group profit. The recent share price rally went beyond our assessed valuation for the company so we decided to exit the position.

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.

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.

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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

Robert Frost *B Com, LLB*, Portfolio Manager

Robert Calnon *B Com, ACA*, Portfolio Manager, Equities Dealer

For Further Information

Financial advisers seeking additional information can contact Ralton Advisers Services at:

Name: John Clothier
Phone: 02 8216 0782
Mobile: 0408 488 549
Email: jclothier@ocfunds.com.au

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STANDARD &POOR'S professional planner