Monthly Report May 2014

Ralton Leaders

RALTON ASSET MANAGEMENT

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 ★★★★

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Leaders	1.49	4.15	17.07	11.47	13.01	6.00
Income Return	0.52	0.87	4.15	4.66	4.46	4.56
Growth Return	0.97	3.28	12.92	6.80	8.55	1.44
S&P/ASX 100 Index	0.69	2.99	16.99	11.08	12.86	4.73
Difference	**0.80**	**1.16**	**0.07**	**0.39**	**0.15**	**1.27**

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

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	ANZ Banking Group	ANZ
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	Recall Holdings Limited	REC

GICS Sector	Ralton	Index	+/-
Industrials	10.2%	6.2%	4.0%
Health Care	7.9%	4.7%	3.2%
Consumer Discretionary	5.5%	2.5%	3.0%
Energy	8.7%	6.0%	2.7%
Telecommunication Services	7.4%	5.2%	2.2%
Information Technology	1.8%	0.7%	1.1%
Materials	17.1%	16.8%	0.3%
Utilities	0.0%	1.7%	-1.7%
Property	4.1%	6.8%	-2.7%
Consumer Staples	3.4%	8.6%	-5.1%
Financials (ex property)	33.8%	40.7%	-6.9%
Total	100.0%	100.0%	

Month in Review

Performance Summary

- The S&P/ASX 100 Accumulation Index added 0.69% for the month of May, with Energy and Utilities the best performing sectors.
- The Ralton Leaders Model Portfolio recorded a solid gain of 1.49% for the month, outperforming the benchmark index by 0.80%.
- At a sector level, a combination of stock selection within the Materials sector and being overweight the Consumer Discretionary sector added to portfolio returns.

Portfolio Commentary

Month Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Aristocrat Leisure	Overweight	Fletcher Building	Overweight
Amcor Ltd	Overweight	QBE Insurance Group	Overweight
Oil Search Ltd	Overweight	ALS Ltd	Not Owned

Positive Contribution

Amcor Limited (AMC, +3.1%) added value to the portfolio, performing relatively strongly thanks to positive market attention as an analysts tour of Asian operations focused attention on the company's prospects in emerging markets. Early in May the company announced the acquisition of Bella Prima Packaging, an Indonesian 'flexible packaging' business, for $A27m. Later in the month, AMC hosted a series of analysts on anits Asian investor tour, focusing on Indonesia and India. The acquisition and the tour together highlighted the importance of the Asian region to the Amcor group. As emerging market populations increase their median income, the demand from consumers for Western-style products and packaging typically accelerates. Amcor has strong substantial intellectual property in the packaging space which is demanded by middle-class consumers, and is a supplier of choice to many of the world's leading global consumer brands (e.g. Unilever and Proctor & Gamble) who themselves are seeking to grow their operations in emerging markets. AMC achieve some 30% of their sales in emerging markets and their ability to continue to grow revenue strongly from these markets, in spite of individual periodic market disruptions, is a core part of our investment thesis for the company.

Aristocrat Leisure's (ALL, +5.6%) half year profit result and profit guidance was well received by investors and the stock added to our relative returns. Although the demand backdrop is modest, particularly in the US, ALL's US gaming operations continue to gain market share, buoyed by the rollout of the 'E*series games'. With clear signs of operating improvement in recent periods and progress in the company's online operations, we remain supportive of the 5-year turnaround plan under CEO Jamie Odell.

Oil Search (OSH, +6.1%) was boosted by the shipment of the 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 2nd LNG train is running ahead of schedule and should commence in June this year. Early commissioning means an earlier path to cash inflows 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 PRL15 and the PNG government. We expect clarification on this front across the balance of 2014.

Negative Contribution

Falling Australian consumer confidence together with a plateau in Australian housing approvals in recent months likely weighed on the Fletcher Building (FBU, -9.6%) share price. The housing cycle in Australia is important to FBU and accounts for some 20% of group profits. Our view is that low interest rates will continue to support the domestic housing industry; however housing approvals are likely to fall from current elevated levels. Our favourable view of FBU is premised on the strength of the NZ economy (where FBU earn 55% of their profits), the improving housing cycle in NZ, and the benefits of CEO Mark Adamson's cost and efficiency program 'FBUnite'.

QBE Insurance (QBE, -1.7%) also detracted from portfolio returns. Contributing to the weakness was the ongoing strength of the Australian dollar, which of course impacts the translation of US dollar profits, and declining government bond yields, which impacts QBE's investment returns and the value of its liabilities. Some technical selling, based upon conversion of a tranche of QBE's convertible subordinated notes, also weighed on the share price, short term.

Portfolio Adjustments

During the Month we...

SOLD:

BOUGHT:

Purchases/Additions

We increased our holding in Recall Holdings (REC), noting the strong start the company has made in terms of acquisitions since the demerger from Brambles at the end of 2013. The company recently acquired US-based CitiStorage for $47.2m. Given their clean balance sheet and a quite fragmented industry, REC are well placed to grow by acquisition, building on the current storage footprint and the high degree of recurring revenue and free cash flow that the business delivers. We also recently attended a meeting with management where they provided far more insight about the moat which exists around the storage business (it is a very sticky business). As counterintuitive as it might seem in this digital age, the demand for long-term hard storage is growing due to regulatory requirements and litigation risks.

Incitec Pivot (IPL) reported their half year results in May, and although the headline profit result exceeded market forecasts, investors were concerned by the need for a prolonged shutdown and production shortfall at the company's fertilizer plant at Phosphate Hill, Queensland. Medium term, we like the footprint of assets that IPL have, and in particular are attracted to the returns available from the Louisiana ammonia plant currently under construction. Using a previously functional 'brownfields' site, the plant offers leverage to the low input cost for gas in the United States, feeding the ammonia plant. Once the plant comes on line, IPL will have a far greater weighting of profits to the explosives sector versus fertilizers, which we believe should lead to a re-rating of the stock. In the interim the company will need to deliver on production targets to build investor confidence.

Disposals

There were no outright sales from the portfolio during May, although we did reduce our exposure to the banking sector by trimming our holding in Australia and New Zealand Banking Group (ANZ) following a strong run in the share price. ANZ's half year profit results were in line with market forecasts, and most individual metrics such as loan losses, loan growth and cost growth delivered as expected. Banks currently offer an attractive yield relative to cash, but at some point the bad and doubtful debt charge will start to rise and this will pressure sector earnings. The timing for this change of direction is uncertain.

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)

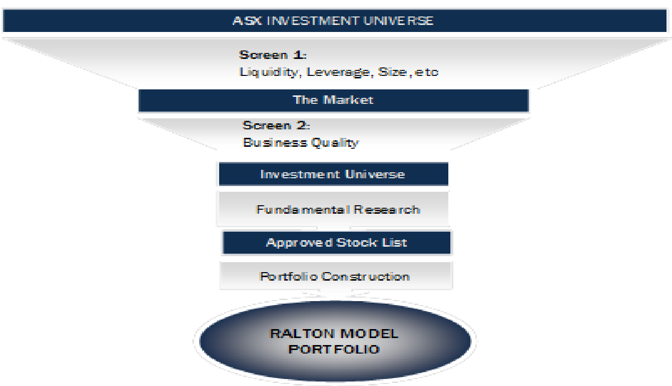
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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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