RALTON
ASSET MANAGEMENT

Quarterly Report September 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 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	-2.61	1.42	9.05	17.62	8.64	6.14
Income Return	0.55	1.28	4.02	4.46	4.46	4.51
Growth Return	-3.16	0.14	5.03	13.16	4.18	1.63
S&P/ASX 300 Accum. Index	-5.37	-0.56	5.73	14.37	6.57	3.47
Difference	**2.76**	**1.98**	**3.31**	**3.25**	**2.07**	**2.67**

**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	BHP Billiton Limited	BHP
4	Telstra Corporation Limited	TLS
5	National Australia Bank	NAB
6	Recall Holdings Limited	REC
7	Oil Search Limited	OSH
8	Origin Energy Limited	ORG
9	Amcor Limited	AMC
10	Westpac Banking Corporation	WBC

GICS Sector	Ralton	Index	+/-
Industrials	14.0%	7.6%	6.4%
Health Care	8.6%	5.4%	3.2%
Consumer Discretionary	8.7%	5.6%	3.1%
Materials	18.1%	16.2%	2.0%
Energy	8.4%	6.9%	1.5%
Telecommunication Services	6.1%	5.6%	0.5%
Information Technology	0.0%	1.0%	-1.0%
Utilities	0.0%	1.9%	-1.9%
Consumer Staples	4.6%	7.6%	-3.0%
Property	2.7%	7.3%	-4.6%
Financials (ex-Property)	28.8%	35.0%	-6.2%
Total	100.0%	100.0%	

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Quarter in Review

Performance Summary

- Despite a strong start, the S&P/ASX 300 Accumulation Index recorded a loss of 0.56% for the September quarter. The top performing sectors were Healthcare and Telecommunications.

- The Ralton Australian Shares Model Portfolio gained 1.42% for the quarter, outperforming the benchmark index by 1.98%.

- This outperformance reflected our overweight position in the Consumer Discretionary and Industrials sectors and our underweight in resource stocks within the Materials sector.

Portfolio Commentary

Quarterly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Recall Holdings	Overweight	Transpacific Industries	Overweight
Orora Limited	Overweight	Oil Search	Overweight
Amcor Limited	Overweight	Sky Network Television	Overweight

Positive Contributors

Recall Holdings (REC, +17.2%) was the portfolio's top contributor for the quarter, buoyed by speculation that they may be a takeover target for US peer Iron Mountain (IRM). IRM is the number one player in the global document storage market and their acquisition of REC, the number two player, would make sense from a synergistic perspective. REC however denied that they had fielded any approach from IRM. Earlier in the quarter, REC shares were boosted by the announcement of productivity improvements across their global storage facilities. The productivity program is consistent with our view that since the demerger from Brambles, REC management has considerable scope for 'self-help' initiatives that will deliver value to shareholders.

Amcor spin-off Orora Limited (ORA, +15.1%) was the portfolio's next-best contributor. The company's maiden profit result, released in August, was well received as key financial targets were achieved. ORA is benefitting from various cost savings derived from a capital investment program and operational improvement initiatives started by its former parent. The new B9 pulp mill in Botany continues to 'ramp-up' production and management confirmed that B9's multi-year commissioning is proceeding broadly in line with expectations.

Amcor Limited (AMC, +8.6%) added to portfolio returns following strong financial results. Cash flow was strong, margins in the key Flexibles division rose strongly year-on-year, and the dividend was higher than market estimates. The company is well positioned for solid revenue growth, having an exposure to global emerging economies and their demand for packaged goods across food, healthcare and hygiene products. Amcor highlighted a $3bn pipeline of acquisition opportunities.

Underperformers

Transpacific Industries (TPI, -19.7%) weighed on portfolio performance after the company announced that they had increased their landfill remediation provision by $189m (after tax), noting the need to spend more cash than previously planned over the next 5 years ($25-35mpa). TPI also grounded their entire waste management fleet nationally during August, following a fatal accident involving one of their vehicles in South Australia. All vehicles were required to pass a roadworthy certificate and all vehicles have subsequently returned to the road. We continue to have confidence the relatively new CEO, Bob Boucher, will be able to deliver improved results over the next few years.

A weakening oil price as the US dollar strengthened contributed to weakness in PNG-focused energy company, Oil Search (OSH, - 7.8%), and detracted from portfolio performance. As discussed last quarter, the company recently shipped their 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).

Finally, Sky Network Television (SKT, -12.2%), one of the portfolio's smaller positions, underperformed this quarter despite posting quite solid profit results for the financial year 2014. The NZ based pay TV operator has an industry leading position in the New Zealand market, where the economy as a whole is strong and demand for its services remain high. SKT were recently unsuccessful in retaining the broadcast rights to several US, European and Asian Golf Tour events, although we would flag these as minor in the scheme of SKT's program rights. Positively for SKT, several higher profile events have recently been retained. Currency movements likely had a small impact on the performance of the Australian listed shares, as the weakening of the NZ dollar against the Australian dollar impacts the value from an Australian perspective.

Portfolio Adjustments

During the Quarter we...

SOLD: Macquarie Group (MQG), Mirvac Group (MGR), Suncorp Group (SUN)

BOUGHT: Sonic Healthcare Limited (SHL)

Portfolio Additions & Material Adjustments

Sonic Healthcare (SHL) was the only new addition to the portfolio for the quarter. We are attracted to SHL's strong business model, doctor-centric culture and management's ongoing focus on improving the investment returns of the business. Sonic have a global pathology business with significant operations in Australia, the US, and several countries in Europe. Recent share price weakness has been driven by the overhang from co-payments legislation as part of the Federal budget. Although regulatory concerns (largely pricing) are omnipresent in the healthcare sector, we believe that SHL's global operations provide a buffer to regional regulatory risk as well as platforms for expansion and growth.

Portfolio Disposals & Material Adjustments

We sold two stocks from the portfolio during the quarter after deciding to reduce our exposure to the financial sector. Firstly we disposed of our final stake in Suncorp Group (SUN), a stock we had acquired in the early stages of its turnaround. The company delivered solid FY14 results across all divisions. However, the insurance pricing cycle has started to peak and it is not clear how much of the planned costs savings will need to be reinvested to protect market share in this environment. Also the market had, in our opinion, started to price in the special dividends as permanent.

We also disposed of our holding in Macquarie Group (MQG). Whilst we like the medium term outlook for MQG, given it's current valuation we are concerned about how it will perform as the US Federal Reserve ends quantitative easing. This was the last of the diversified financial holdings in the portfolio.

We took some profits in Mirvac Group (MGR). The stock has re-rated well since acquisition and no longer trades at the discount to net tangible assets (NTA) it had at the time of purchase. Property sales in the company's residential division have been strong, reflective of the rise in demand for residential property. Although the housing cycle may remain at current highs we believe that the scope for further upside here is modest and hence are comfortable taking profits in this stock.

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)

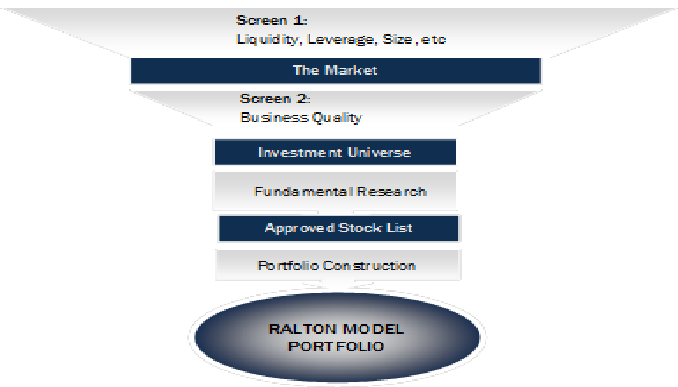
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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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