Monthly Report August 2014

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	Amcor Limited	AMC
9	QBE Insurance Group	QBE
10	Aristocrat Leisure Limited	ALL

GICS Sector	Ralton	Index	+/-
Industrials	13.0%	6.5%	6.5%
Health Care	8.6%	5.1%	3.4%
Telecommunication Services	8.1%	5.1%	3.0%
Consumer Discretionary	6.2%	3.4%	2.8%
Energy	7.9%	7.0%	0.9%
Materials	17.0%	16.5%	0.5%
Information Technology	0.0%	0.7%	-0.7%
Utilities	0.0%	1.9%	-1.9%
Property	3.1%	6.9%	-3.8%
Consumer Staples	2.9%	8.0%	-5.1%
Financials (ex-Property)	33.2%	38.9%	-5.7%
Total	100.0%	100.0%	

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Leaders	0.71	2.96	14.79	16.03	9.80	6.23
Income Return	0.80	0.92	4.08	4.64	4.49	4.53
Growth Return	-0.09	2.04	10.72	11.40	5.31	1.70
S&P/ASX 100 Index	0.50	3.35	14.73	15.36	9.72	5.07
Difference	**0.21**	**-0.39**	**0.06**	**0.68**	**0.08**	**1.16**

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

Month in Review

Performance Summary

- The S&P/ASX 100 accumulation index added 0.50% for the month, with Energy and Financials being the top performing sectors.
- The Ralton Leaders Model Portfolio gained 0.71% for the month, outperforming the benchmark index by 0.21%.
- The portfolio's outperformance was driven by our overweight exposure to the Energy sector, together with our underweight to resource stocks within the Materials sector. These positives were somewhat tempered by stock specific losses within the Industrial sector.

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Amcor Limited	Overweight	Transpacific Industries	Overweight
Orora Limited	Overweight	Recall Holdings	Overweight
QBE Insurance	Overweight	Sonic Healthcare	Overweight

Positive Contributors

Company reporting season for the end of Financial Year 2014 was a key driver of share performance in August. Amcor Limited (AMC, +9.5%) added to portfolio returns following strong financial results, headlined by a 25% increase in net profits. Cash flow was strong, margins in the key Flexibles division rose strongly year-on-year, and the dividend was commensurately higher than market estimates. Going forward the company is well positioned for solid revenue growth, with 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. We expect that acquisitions will continue to be a key part of AMC's growth strategy and make incremental contributions to shareholder returns.

Amcor spin-off Orora Limited (ORA, +12.2%) was the portfolio's next best contributor. The company's maiden profit result was well received as key financial targets were achieved. ORA is benefitting from various cost savings following a multi-year 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. Successful ramp-up to full production is key to ORA achieving the cost savings targets that are baked into the market's profit expectations. ORA's US packaging operations also reported strong results, with the company highlighting the acquisition of a small operation in Texas.

QBE Insurance (QBE, +4.7%) added value to the portfolio as management released their half-year financial update along with a comprehensive capital plan. Firstly, QBE announced a US$750m equity raising, largely to finance the repurchase of a maturing convertible note. Secondly, it announced plans for the outright sale of its American agencies, together with a partial sale of its Australian agencies. Thirdly, QBE are planning for the partial IPO of QBE's LMI or Lenders Mortgage Insurance business in Australia. Overall, these measures were well received as they continue the portfolio clean-up and simplification under CEO Neale's tenure.

Underperformers

Transpacific Industries (TPI, -15.6%) 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 $125-175m 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 before returning to the road. We believe this decision was the correct one. 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.

Recall Holdings (REC, -7.4%) detracted from returns after announcing the company's profit guidance for the coming year would not match market expectations. The key issue was management's statement that costs would remain elevated in the coming financial year, whereas after REC's June announcement of a Facility Optimisation Program, i.e. productivity improvements across their global storage facilities, the market had built up high expectations of near term cost savings. We note that since the demerger from Brambles in late 2013 management have been very clear that costs, particularly on the sales side, needed to grow, to continue to drive revenue growth. This is being done after an extended period where costs were cut across this business by BXB, to "dress" Recall up for sale to private equity. Our view is that the cost savings REC have targeted are achievable and will be delivered in the medium term. We have confidence that management initiatives, including selective M&A, new contract wins (eg HSBC), and the Facility Optimization Program, will deliver stable profit growth for investors.

A cautious outlook commentary from Sonic Healthcare (SHL, -3.0%) saw the stock underperform in August. Profit results for the full year produced 5.4% growth in constant currency EBITDA, in line with company guidance to the market. Reported profit growth was stronger however, with interest savings and foreign currency impacts producing 15% growth in profits for Financial Year 2014. The company's own 'slightly conservative' Financial Year 2015 guidance is for constant currency growth of 5% EBITDA once more. As per expectations, operating conditions for SHL in UK and Europe continue to be strong, whilst US conditions are improving, driven by both internal cost savings and external demand for healthcare services as the economy strengthens. SHL however cited a slowing in volume demand in Australia – budget uncertainty around the co-payment to doctors has tempered demand even though it is not yet law, nor does not it appear likely the legislation will pass the senate in its current form. We are happy to look beyond these short term machinations and maintain our long term belief in the SHL investment, particularly given the diverse geographic exposure that SHL offers.

Portfolio Adjustments

During the Month we...

SOLD: Computershare (CPU), Macquarie Group (MQG), Suncorp Group (SUN)

BOUGHT:

Portfolio Additions & Material Adjustments

There were no new stock additions to the portfolio during the month, although we used share price weakness to add to each of Echo Entertainment (EGP), Incitec Pivot (IPL), and TPI (as discussed above).

Portfolio Disposals & Material Adjustments

We disposed of three stocks from the portfolio during August as part of a process of reducing our exposure to the financial sector. Firstly we disposed of our final stake in Suncorp which 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 stay with the stock, we are concerned about how it will perform as the US Federal Reserve ends qualitative easing, given its current valuation. This was the last of our diversified financial holdings in the portfolio.

Finally, the position in Computershare (CPU) was also disposed of after a review of our investment thesis post the company reporting its financial year 2014 results.

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)

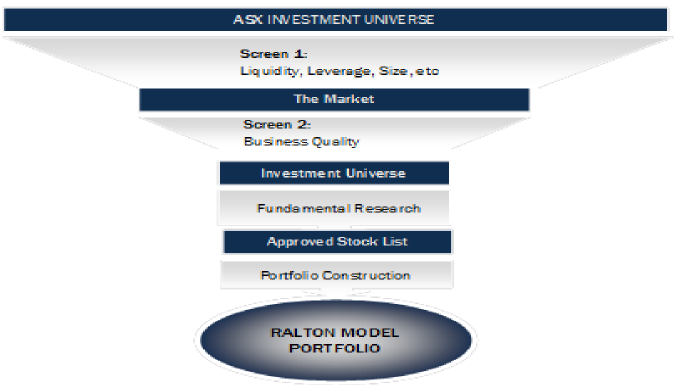
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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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