Monthly Report August 2014

RALTON ASSET MANAGEMENT

Ralton Smaller Companies

Winner of the 2010 Standard & Poors' Fund Awards
- Separately Managed Accounts Category

Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Ralton Smaller Companies 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 Smaller Companies SMA is to provide investors with long-term capital growth and some tax effective income from a concentrated portfolio of smaller capitalisation ASX listed 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 Small Ordinaries Accumulation Index
Authorised Investments	ASX listed companies that are not included in the S&P/ASX 50 Index
Number of Stocks	25-40
Cash Allocation	0% to 15%
Tracking Error	5% to 9% per annum
Investment Horizon	At least 5 years
Ratings	MORNINGSTAR ★★★★ LONSEC Investment Grade SMA

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Smaller Companies	1.23	3.07	17.70	15.95	14.07	6.89
Income Return	0.26	0.47	3.24	3.77	3.74	3.85
Growth Return	0.97	2.61	14.46	12.19	10.34	3.04
S&P/ASX Small Ords Acc Index	2.34	6.17	7.49	-0.17	1.85	-2.33
Difference	**-1.10**	**-3.10**	**10.20**	**16.12**	**12.22**	**9.21**

*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	Fisher & Paykel Healthcare Corporation	FPH
2	Sky Network Television Limited	SKT
3	Fletcher Building Limited	FBU
4	Virtus Health Limited	VRT
5	Orora Limited	ORA
6	Beach Energy Limited	BPT
7	Recall Holdings Limited	REC
8	Blackmores Limited	BKL
9	Invocare Limited	IVC
10	ISelect Limited	ISU

GICS Sector	Ralton	Index	+/-
Consumer Discretionary	31.0%	22.7%	8.3%
Health Care	9.4%	4.8%	4.6%
Consumer Staples	6.3%	2.4%	3.9%
Energy	7.1%	5.5%	1.5%
Industrials	18.2%	17.1%	1.1%
Information Technology	3.5%	2.5%	1.0%
Financials (ex-Property)	7.0%	8.0%	-1.0%
Utilities	1.5%	2.6%	-1.1%
Property	2.8%	8.6%	-5.8%
Telecommunication Services	3.1%	9.1%	-6.0%
Materials	10.2%	16.8%	-6.5%
Total	100.0%	100.0%	

Month in Review

Performance Summary

- The S&P/ASX Small Ordinaries Accumulation Index moved higher again in August, adding 2.34%, with Information Technology and Telecommunications the best performing sectors.
- Over the same period the Ralton Smaller Companies Portfolio added 1.23%, underperforming the benchmark by 1.11%.
- At a sector level, the portfolio's underweight exposure to Materials added value to relative returns, although this was offset by stock specific losses in the Industrials sector.

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Orora Limited	Overweight	Transpacific Industries	Overweight
Chandler Macleod Grp	Overweight	Recall Holdings	Overweight
Slater & Gordon Ltd	Overweight	Horizon Oil	Overweight

Positive Contributors

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.

Recruitment services company Chandler Macleod (CMG, +23.6%), also added to portfolio returns. CMG's reported profits exceeded expectations, although these expectations had been reset when the company downgraded profit expectations at the beginning of May, leading to considerable share price weakness at the time. Internal cost savings were a key feature of the Financial Year 2014 result, with management indicating that there is further potential on this front as various operations are simplified and key contracts scrutinized for both their profitability and cost to serve from CMG's perspective. The trend for hours worked in the blue collar recruitment segment has continued to improve and results for the newer divisions of AHS and Vivir - contract services to hotel chains and physiotherapist services (largely to nursing homes) - continue to show good growth. Strong cash flow for Financial Year 2014 supported the board's decision to perform an on-market share buyback of CMG shares. We continue to believe that CMG is largely a self-help story, although given the economic sensitivity of employment and contractor demand, we continue to monitor economic conditions closely.

Law firm Slater & Gordon (SGH, +26.1%) had a strong month following the release of their annual profit result. SGH's move into the UK legal market via acquisition is proceeding according to plan and this was well received by the market. SGH also made two small acquisitions in Australia, both of which are focused on general law practice, as distinct from their core focus in both Australia and the UK, which is personal injury law.

Negative Contributors

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.

Horizon Oil (HZN, -9.3%), which had been pursuing a merger with ROC Oil (ROC), lost ground when ROC itself received a takeover offer from Fosun International Limited. When ROC directors accepted the offer from Fosun, the HZN merger was effectively terminated. Although this development is somewhat disappointing in the short term it does not detract from the quality of assets that HZN own. We expect that HZN will be pursuing all avenues to bring their key project, the gas focused Stanley project in the West of PNG, to development.

Portfolio Adjustments

During the Month we...

SOLD: Acrux Limited (ACR), Magellan Financial Group (MFG)

BOUGHT:

Portfolio Additions & Material Adjustments

There were no new stock additions to the portfolio for the month. We did however increase our position in Virtus Health (VRT) following their Financial Year 2014 results and delivery of profit forecasts for their prospectus period. We continue to like VRT's position in the Australian IVF sector and see merit in their recent offshore moves into Singapore and Ireland respectively.

Portfolio Disposals & Material Adjustments

We elected to sell the reminaing holding in the drug delivery specialist Acrux Limited (ACR) after a strong rebound in the share price. Acrux's key drug is Axiron, a testosterone replacement therapy used largely in elderly males. The market and use of testosterone more broadly will be subject of an FDA safety panel hearing in September. Although we believe that a materially adverse safety outcome impacting Axiron as a result of this panel hearing is unlikely, we took the view that the current risk/reward was unfavourable and elected to sell.

We also took some profits in long held positions Tassal Group (TGR) and Village Roadshow (VRL), although we remain holders of each 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

Robert Frost *B Com, LLB*, Portfolio Manager

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For Further Information

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