RALTON ASSET MANAGEMENT

Monthly Report October 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	

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton High Yield	4.32	2.71	9.46	18.59	10.89	7.42
Income Return	0.00	1.57	4.77	4.92	4.91	5.06
Growth Return	4.32	1.15	4.70	13.67	5.97	2.36
S&P/ASX 300 Acc. Index	4.27	-0.70	5.97	13.30	7.91	4.07
Difference	**0.06**	**3.41**	**3.49**	**5.29**	**2.97**	**3.35**

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

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	BHP Billiton Limited	BHP
5	National Australia Bank Limited	NAB
6	Westpac Banking Corporation	WBC
7	Amcor Limited	AMC
8	Incitec Pivot Limited	IPL
9	Origin Energy Limited	ORG
10	Sonic Healthcare Limited	SHL

GICS Sector	Ralton	Index	+/-
Industrials	15.3%	7.5%	7.8%
Consumer Discretionary	9.4%	5.6%	3.9%
Telecommunication Services	8.4%	5.6%	2.8%
Energy	7.1%	6.4%	0.6%
Materials	16.1%	15.5%	0.6%
Utilities	1.8%	1.8%	0.0%
Health Care	5.2%	5.4%	-0.2%
Information Technology	0.0%	1.0%	-1.0%
Consumer Staples	4.6%	7.7%	-3.0%
Property	2.7%	7.4%	-4.7%
Financials (ex-Property)	29.4%	36.0%	-6.6%
Total	100%	100%	

RALTON ASSET MANAGEMENT

Month in Review

- The S&P/ASX 300 Accumulation Index recorded a strong gain of 4.27% for October, with all market sectors except Energy rising over the month.
- The Ralton High Yield Model Portfolio returned 4.32%, essentially in line with the benchmark.
- On a sector basis, the portfolio's overweight position in the Consumer Discretionary sector was the key contributor to portfolio returns, offsetting underperformance in the Energy sector.

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Aristocrat Leisure	Overweight	Origin Energy	Overweight
Incitec Pivot	Overweight	QBE Insurance	Overweight
Sonic Healthcare	Overweight	Woodside Petroleum	Overweight

Positive Contributors

Aristocrat Leisure (ALL, +9.8%) continued its recent strong run and was a positive contributor to portfolio performance for the month. Industry feedback and sales data has confirmed that ALL is gaining share with their products in key markets. This confirms for us that the heavy investment in talent and content over recent years is bearing fruit. In addition, ALL's online or 'app' based software is gaining users, recording good growth in 'MAU' or monthly average users, lead by 'Product Madness' and 'Heart of Madness.' Also, Aristocrat confirmed the early settlement of their acquisition of US based Video Gaming Technologies (VGT), having completed all necessary regulatory requirements nearly six months earlier than expected.

Incitec Pivot (IPL, +7.4%) outperformed the market in October, despite a lack of any company specific news-flow. Our investment thesis for IPL centres on the strong cash flows that will follow completion of their Louisiana ammonia plant and the successful ramp-up of production from the Moranbah ammonium nitrate plant in Queensland. The latter appears well on track given feedback from the company's investor day in Sydney in October. We also received positive feedback on the shut down and refurbishment of IPL's Phosphate Hill fertilizer plant in Queensland, which in recent times has been unreliable in terms of production. We now await the full year results announcement in November for further news flow.

Global pathology player Sonic Healthcare (SHL, +6.5%) was boosted by its selection as preferred provider for a long-term contract in Edmonton, Canada. The contract will see SHL achieve starting revenues of approximately C$200m and increasing over the 15-year term of the contract. This contract is consistent with the global trend for governments to outsource their healthcare services , and follows a similar win by SHL in the UK earlier this year. Although long established in the United States and several European countries, this will be Sonic's first significant contract in Canada.

Underperformers

Our overweight position in the Energy sector detracted from portfolio returns in October. The oil price has fallen some 25% since mid-year, triggered by increased supplies (mainly from the US) and negligible demand growth from the global economy. Oil demand growth rates are falling in key emerging market oil consumers such as China, as economic growth slows. Typically when the oil price stages a significant decline in a short space of time, OPEC responds by cutting production (often by key producer Saudi Arabia). However this has not yet happened, suggesting that the Saudis are comfortable with the lower oil price.

The weakening oil price was a contributor to the softness in the Origin Energy (ORG, -4.7%) share price. ORG performed slightly worse than the energy sector as a whole, which declined by 3.6% for the month. ORG held an investor day at Gladstone where they showed the progress at the APLNG site. Construction of the project's upstream (gas production and pipelines) and downstream (LNG manufacturing) facilities is now more than 80% complete. ORG have maintained their target for first LNG production by mid 2015 with both of the LNG 'trains' operational by the end of financial year 2016.

Shares in Woodside Petroleum (WPL, -1.2%) were also impacted by the falling oil price in October, although fared better than the sector as a whole. Woodside is currently producing significant cash flows from its two main assets – Pluto LNG and the NW Shelf LNG - and paying the proceeds to investors in the form of a strong, fully franked dividend. Under CEO Coleman, the company has been patiently assessing and considering their growth options, including Browse off the coast of WA and Sunrise in the East Timor Sea, whilst also buying into a series of earlier stage oil projects across the world.

These growth projects will drive the strategic direction for WPL over the next 10 years and hence we are supportive of the patience being demonstrated by management.

QBE Insurance (QBE, -1.1%) was weaker across October, against the solid rise in the market overall. This decline was likely due to the substantial fall during the month in global bond yields. This is negative for QBE as it reduces the expected re-investment rate on its massive investment book and increases its liabilities (through its impact on the discount rate). We also had a number of stocks which benefited during the month from the decline in yields, including Telstra, Transurban and Sydney Airports.

Portfolio Adjustments

During the Month we...

SOLD: Chandler Macleod (CMG)

BOUGHT: Mermaid Marine (MRM), Resmed (RMD)

Portfolio Additions & Material Adjustments

We added two stocks to the portfolio in October, namely Resmed (RMD) & Mermaid Marine (MRM). RMD is a global manufacturer and distributor of machines and masks for the treatment of sleep apnea, and hospital- and home-based treatments for other respiratory conditions. Manufacturing initiatives, new and improved patient masks, and an expanding share of the sleep apnea market will all help drive RMD's future growth. Recent regulatory changes in the United States relating to home sleep testing and diagnosis for people suspected of sleep apnea (previously all patients had to attend overnight sleep centre) together with requirements around testing of truck drivers for sleep apnea are positives for RMD. Future clinical trials looking into links between sleep apnea and various other conditions such as cardiovascular disease could also further expand the market.

Mermaid Marine (MRM) is a WA-based service provider to the oil and gas industry, with two core business divisions. Firstly they own, and lease to the oil and gas industry, a range of specialised marine vessels. Typically the leases are on a 1 to 3 year basis. Secondly they own supply bases in Dampier and Broome. These give MRM a strategic advantage and allow them to provide a range of port and storage services to the major oil and contract companies operating in the NW shelf. In February this year, MRM embarked on a significant transaction with the purchase of Singapore listed Jaya Holdings for $A550m. Like MRM, Jaya own a series of marine vessels and associated assets, rented out to the oil and gas industry, though Jaya's geographic exposure is far more diverse. The purchase was funded via a combination of debt and the issuance of new shares. Since then the MRM share price has weakened materially. Our view is that the acquisition of Jaya makes strategic sense as it allows MRM to diversify its geographical exposure to the offshore oil and gas industry, ahead of an anticipated drop off in demand for services in the NW region of Australia as key projects are completed and not replaced with new ones. With the share price and value of the company having fallen below the level of net tangible assets (ie the value of the boats and supply bases, less debt) we have begun to build a position in the stock.

Portfolio Disposals & Material Adjustments

Chandler Macleod (CMG) was the only outright sale from the portfolio. As mentioned a few months ago we have been cautious on the Australian economy in terms of its influence on demand for contract and short-term labour, a key plank of CMG's offering. Given our continued cautiousness on this front, we took the recent increase in the share price as an opportunity to exit the stock and deploy the cash into stocks where we felt the risk/reward was superior.

We also took some profits in Recall Holdings (REC) following the stock's recent share price performance. The share price has re-rated significantly since the Brambles demerger, buoyed (in our opinion) by investors' better understanding of the business, together with a series of operational improvements by management. Recently, the share price rose on speculation that REC 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.

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)

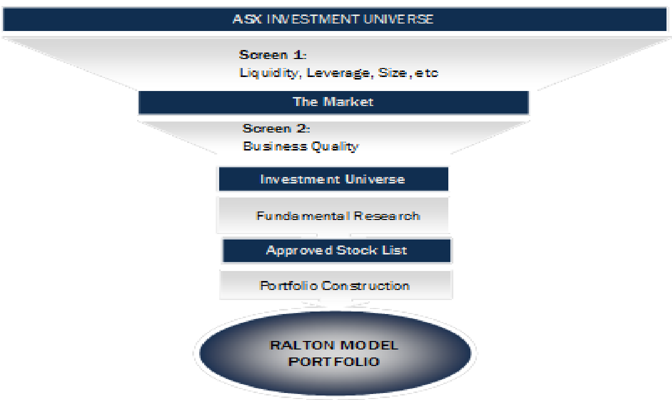
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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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