Monthly Report October 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	MORNINGSTAR ★★★★

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Leaders	4.84	2.77	9.72	4.84	9.72	6.39
Income Return	0.00	1.33	4.10	0.00	4.10	4.50
Growth Return	4.84	1.43	5.62	4.84	5.62	1.90
S&P/ASX 100 Index	4.70	-0.41	6.68	4.70	6.68	4.80
Difference	**0.14**	**3.18**	**3.04**	**0.15**	**3.04**	**1.59**

**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	Telstra Corporation Limited	TLS
4	BHP Billiton Limited	BHP
5	National Australia Bank Limited	NAB
6	Westpac Banking Corporation	WBC
7	Aristocrat Leisure Limited	ALL
8	Amcor Limited	AMC
9	QBE Insurance Group	QBE
10	Oil Search Limited	OSH

GICS Sector	Ralton	Index	+/-
Industrials	12.3%	6.5%	5.8%
Consumer Discretionary	8.3%	3.5%	4.8%
Health Care	9.7%	5.5%	4.2%
Telecommunication Services	7.0%	5.1%	1.9%
Energy	8.3%	6.5%	1.7%
Materials	16.8%	15.7%	1.1%
Information Technology	0.0%	0.7%	-0.7%
Utilities	0.0%	2.0%	-2.0%
Property	3.1%	7.2%	-4.1%
Consumer Staples	2.8%	8.2%	-5.4%
Financials (ex-Property)	31.7%	39.3%	-7.5%
Total	100.0%	100.0%	

Month in Review

Performance Summary

- The S&P/ASX 100 Accumulation Index rebounded strongly in October, adding 4.70%, lead by strength in the Financials and Telecommunications sectors.
- The Ralton Leaders Model Portfolio gained 4.84% for the month, outperforming the benchmark index by 0.14%.
- This outperformance was driven by our overweight exposure to the Consumer Discretionary and Industrials sectors, offset to some degree by our overweight position in the Energy sector

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Echo Entertainment	Overweight	Oil Search	Overweight
Aristocrat Leisure	Overweight	Origin Energy	Overweight
Lend Lease	Overweight	QBE Insurance	Overweight

Positive Contributors

Echo Entertainment (EGP, +15.9%) CEO Matt Bekier and his team continued to deliver on their recent strong performance, with EGP the portfolio's top performer for the month. The improved return on the massive investment in the Star Casino in Sydney has been achieved by improvements in marketing, the loyalty program and service offerings. We believe that this turnaround has some way to go before it matures. The recent AGM update confirmed strong revenue trends so far this financial year for the main gaming floor and VIP customers at both the Star and EGP's smaller Queensland operations.

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.

Lend Lease Group (LLC, +9.2%) was boosted in October by contract wins and the positive outlook presented at their investor day. LLC, together with their partners, confirmed that they had reached financial close on the $5.3billion Public Private Partnership (PPP) for construction of the East West Link in Melbourne. Our view is that LLC will be a strong beneficiary of what appears to be an impending infrastructure investment phase (perhaps not a boom!) in Australia, particularly along the East Coast. Illustrative of this theme, LLC's engineering backlog stands at $5.3bn, up from $2.1bn in June this year. At the investor day, LLC were also keen to highlight the opportunities that lie ahead in the United States, particularly in the areas of healthcare and urban regeneration where LLC has significant expertise.

Underperformers

Our overweight position in Energy stocks 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 mainly 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 share price softness in Oil Search (OSH, -3.3%). OSH performed slightly better than the energy sector as a whole, which declined by 3.6% over the month. OSH held a strategy day in October where they highlighted the outlook for future LNG plants in Papua New Guinea and the proposed use of free cash flow. This confirmed our understanding of the approach management is planning to adopt.

Shares in Origin Energy (ORG, -4.7%) were also impacted by the falling oil price this month. ORG also 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.

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:

BOUGHT: Bank of Queensland (BOQ), Caltex Australia (CTX), Navitas Limited (NVT)

Portfolio Additions & Material Adjustments

Navitas Limited (NVT) was one of three new stock additions to the portfolio during the month. NVT is an education service provider whose core business is providing 'pathway' courses for students ahead of university entrance. NVT have a global network of 'colleges' across four continents. These 'colleges' provide NVT courses, typically on campus at a 'host' university. NVT source the bulk of their students from international markets, via their own recruitment networks. The share price has weakened recently following the loss of a contract with one major partner or host university. We are confident that, as this contract was terminated as part of the host university's branding strategy, this does not threaten the long term business model of NVT. With a growing presence in the US, established patiently over recent years, and improving performance from NVT's technology-focused CAE division, we believe the outlook for NVT is favourable.

We have also begun to build a position in Caltex (CTX) in the portfolio. The business has undergone considerable structural change in recent years, highlighted by the recent closure of CTX's largest fuel refinery in Sydney. With this volatile element removed from the business, CTX is now principally a distributor of fuel (diesel, petrol and specialist products) to the transport sector and to retail customers through its petrol stations (either company-owned or franchised). We believe that the Caltex of tomorrow offers steady growth prospects that are GDP-like and capital light (as compared to running a refinery which requires a large investment in oil inventory). We expect the company's share price to continue to re-rate as the transition unfolds.

Finally, we added a small position in Bank of Queensland (BOQ) after the bank sector as a whole had sold off significantly. BOQ's operations had improved considerably under former CEO Stuart Grimshaw and potentially, BOQ could be a net winner from proposed changes flowing from the Murray inquiry into the financial services industry – assuming that the competitive advantage that the big four banks hold over regional banks is somewhat reduced.

Portfolio Disposals & Material Adjustments

There were no outright sales for the portfolio across the month, however we did take some profits in Recall Holdings (REC) following the stock's recent share price performance. The share price has rerated 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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