RALTON ASSET MANAGEMENT

Ralton Leaders

Monthly Report November 2014

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	-1.23	0.79	9.34	16.92	8.66	6.12
Income Return	0.61	1.14	4.11	4.51	4.48	4.54
Growth Return	-1.84	-0.35	5.23	12.41	4.18	1.59
S&P/ASX 100 Index	-3.20	-4.09	4.58	14.72	7.56	4.24
Difference	**1.97**	**4.87**	**4.76**	**2.20**	**1.10**	**1.88**

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	Amcor Limited	AMC
7	CSL Limited	CSL
8	Aristocrat Leisure Limited	ALL
9	Westpac Banking Corporation	WBC
10	ResMed Inc.	RMD

GICS Sector	Ralton	Index	+/-
Industrials	13.7%	6.6%	7.0%
Consumer Discretionary	8.7%	2.6%	6.1%
Health Care	11.2%	5.5%	5.6%
Materials	16.7%	15.1%	1.6%
Energy	6.6%	5.1%	1.5%
Telecommunication Services	6.8%	5.7%	1.1%
Information Technology	0.0%	0.6%	-0.6%
Utilities	0.0%	1.9%	-1.9%
Property	2.5%	7.5%	-5.0%
Consumer Staples	1.2%	7.9%	-6.7%
Financials (ex-Property)	32.6%	41.3%	-8.7%
Total	100.0%	100.0%	

Month in Review

Performance Summary

- The S&P/ASX 100 Accumulation Index lost ground in November, falling 3.20%, with Energy and Consumer Staples the worst performing sectors
- The Ralton Leaders Model Portfolio lost only 1.23%, outperforming the benchmark index by 1.97%
- This outperformance was driven by our overweight exposure to the Consumer Discretionary and Industrials sectors, offset to some degree by our overweight to the Energy Sector

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Recall Holdings	Overweight	Origin Energy	Overweight
ResMed Inc.	Overweight	Oil Search	Overweight
Amcor Limited	Overweight	Sonic Healthcare	Overweight

Positive Contributors

Recall Holdings (REC, +9.9%) was the portfolio's top contributor for the month. At the company's AGM, management highlighted stable operating conditions in end markets and the continued execution of strategic initiatives. REC recently completed both the purchase of Business Records Management, a significant bolt-on acquisition in the United States market, and the previously announced transaction to sell the German SDS (Secure Destruction) operations. Also of note, the REC board is now formally investigating the benefits of converting to a REIT (Real Estate investment Trust); industry leader Iron Mountain (IRM) completed their conversion to REIT in the US earlier this year. REIT conversion is a complex, lengthy process and would incur considerable transaction costs, however it may well add value for REC investors on the basis of an improved tax status.

ResMed Inc. (RMD, +5.6%) was the portfolio's next best performer. The company's recently launched 'S10' device, used in the treatment of obstructive sleep apnea, appears to be getting some early traction in the market, and investors were also buoyed by RMD's recent quarterly results which suggested that US pricing pressures were moderating. The fall in the Australian dollar is also a positive for RMD, given that the majority of their profits are earned offshore. Also of interest was RMD's move to sell their 'S+', a sleep monitoring device, through Apple stores in the US. The S+ provides a daily snapshot of overall health and fitness in an Apple friendly format, capitalising on the fact that medical data processing, informatics and the communication of patient data to medical staff, insurers, and distributors is becoming more and more important.

Amcor Limited (AMC, +3.8%), one of the portfolio's largest and long held positions, also boosted returns. The company's AGM highlighted the attractiveness of the Amcor investment as steady growth in western markets is well supported by growth in the company's emerging market operations. It is worth noting that Amcor's emerging market exposure is well diversified, with operations in nearly 30 countries across the three key regions of Asia, Latin America and Eastern Europe. This diversity limits the profit impact in any given period of political, weather, or currency fluctuations destabilising any particular emerging market. We also noted management's positive tone at the AGM in relation to potential acquisitions. Given AMC's excellent acquisition track record under CEO MacKenzie, we are comfortable that any significant transaction will meet the company's return hurdles.

Underperformers

The reluctance of global oil cartel OPEC to cut production saw the oil price fall 18% during November. This in turn impacted our Energy stocks, with Oil Search (OSH, -7.7%) and Origin Energy (ORG, -14.2%) the two largest detractors from portfolio performance.

One can speculate as to the political or other motivations of OPEC - ISIS and countries such as Russia for example are heavily dependent on oil profits - however it is clear that OPEC wants others, not themselves, to cut production and thereby restore balance to the market. US shale producers, who have been the cause of the increased supply, are the likely targets. With 50% of US shale oil production having 'cash' costs above US$65, we would expect a rational supply response from this market, whose owners are of course profit, not politically, driven. However, until supply is reduced we believe that the oil price will remain volatile and that a trading range from say US$60 to US$80 for Brent is likely in the medium term.

For stocks, the lower oil price leads to lower profits and cash returns. From a portfolio perspective, we elected to reduce our holding in ORG during the month. ORG is entering a critical phase, with cash flows from the large Gladstone APLNG plant likely to start around mid 2015, but the company still spending capital as the project moves toward completion. The lower oil price is pressuring ORG's financial position and may see the company raise equity prior to APLNG starting. We would support such a measure if it comes to pass, and also reiterate that our medium term investment thesis for ORG remains intact.

Global pathology player Sonic Healthcare (SHL, -6.6%) retraced last month's gains following an earnings downgrade at its AGM in November. The company reduced financial year 2015 profit guidance from 5% EBITDA growth in constant currency to a range of 2-4% EBITDA growth. Management cited weaker volumes in their Australian pathology business following the Government's proposal of patient co-payments for GP and pathology visits. Even though the measure has not passed the Parliament, it seems patients were sufficiently confused and distracted to defer attendance. Importantly, SHL believes that pathology volumes have been returning to normal over recent weeks, although the lost volume will not be recouped this financial year. Pleasingly for investors, SHL's German, Swiss and US operations are largely meeting or exceeding company forecasts. Further, SHL continues to advance discussions for a large regional contract in Edmonton, Canada - as we discussed last month, SHL are the preferred provider for this contract, which should deliver an incremental $C200m revenues to the group.

Portfolio Adjustments

During the Month we...

SOLD: Fletcher Building Australia (FBU), Westfarmers Ltd (WES)

BOUGHT:

Portfolio Additions & Material Adjustments

There were no new portfolio additions for the month, although we added selectively to existing holdings Amcor Limited (AMC) and CSL Ltd (CSL). Late in October, CSL struck a deal to acquire Novartis' seasonal influenza (flu) vaccine business for US$275m. Novartis are a forced seller, having acquired various assets as part of an asset swap with fellow pharmaceutical major, GSK. For CSL the deal appears to have been done at an exceptional price, acquiring mostly new assets, strong R&D pipeline and consolidating CSL's position as clear No 2 in the global flu market. Subject to deal completion and various milestones being met, it appears that CSL will make very strong returns on their purchase.

Portfolio Disposals & Material Adjustments

There were two outright sales from the portfolio across the month, namely Fletcher Building (FBU), and Wesfarmers (WES), each sale decision largely based on the stock trading at fair value. In addition, each business has a heavy exposure to the Australian economy, and we remain concerned about the outlook for the domestic economy in 2015 given the impact of further falls in the terms of trade and likely measures required by the Federal Government to improve the position of the budget.

Starting with WES, the company was trading at what we considered a reasonably full valuation in the current market. WES has been successful in turning around the top line sales growth and margins at their key business, Coles supermarkets. The easy gains here have been made however and the outlook for this key division is moderating. As highlighted in recent market updates by Woolworths and Metcash (MTS), the supermarket industry in Australia is becoming increasingly competitive. Discounters Aldi and (to a lesser extent) CostCo are gaining market share and the consumer is becoming far more cost conscious.

FBU has been a beneficiary of both the strength in the NZ economy, driving a strong housing cycle, and a cost and efficiency focus directed by CEO Adamson. Going forward, our sense is that the NZ housing and construction cycle is at or near peak, and that in Australia, FBU's leverage to a housing recovery is muted given the product mix of businesses that FBU own. FBU will be only a modest beneficiary of any infrastructure boom in Australia, and our preference is to play this thematic through Lend Lease (LLC).

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)

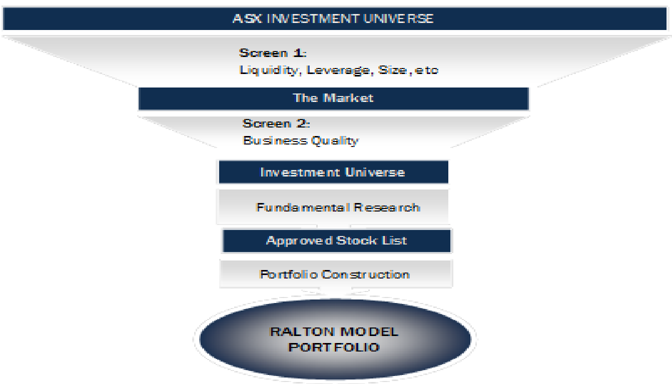
The first stage of the process is to narrow the number of stocks in the investment universe by applying a number of screens. This approach systematically eliminates companies that do not meet certain minimum standards, allowing the Investment team to focus more intensely on companies of potential interest.

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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