RALTON ASSET MANAGEMENT

Monthly Report January 2015

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 ★★★★ Approved Lonsec Research

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	Blackmores Limited	BKL
3	Sky Network Television Limited	SKT
4	iSelect Limited	ISU
5	Aristocrat Leisure Limited	ALL
6	Fletcher Building Limited	FBU
7	News Corporation	NWS
8	Cash Converters International Limited	CCV
9	Pact Group Holdings Limited	PGH
10	Orora Limited	ORA

GICS Sector	Ralton	Index	+/-
Consumer Discretionary	35.3%	24.4%	10.9%
Health Care	13.4%	6.5%	6.9%
Utilities	3.4%	0.7%	2.7%
Consumer Staples	6.5%	4.2%	2.3%
Industrials	14.5%	13.9%	0.5%
Materials	3.4%	4.6%	-1.3%
Information Technology	13.5%	15.4%	-2.0%
Energy	3.1%	5.0%	-2.0%
Financials (ex-Property)	2.2%	5.2%	-3.1%
Telecommunication Services	4.9%	8.2%	-3.4%
Property	0.0%	11.8%	-11.8%
Total	100.0%	100.0%	

Performance

Return %	1m	3m	1yr	3yrs	5yrs	Incept*
Ralton Smaller Companies	1.41	3.24	11.99	17.15	12.16	6.78
Income Return	0.00	0.16	3.17	3.65	3.68	3.81
Growth Return	1.41	3.08	8.82	13.50	8.48	2.97
S&P/ASX Small Ords Acc Index	0.91	-2.49	-0.18	-1.60	-0.30	-3.40
Difference	**0.50**	**5.73**	**12.17**	**18.75**	**12.46**	**10.17**

*Since Inception p.a., Feb 2008

Month in Review

Performance Summary

- The S&P/ASX Small Ordinaries Accumulation started 2015 in positive fashion, adding 0.91% for January, with Financials and Materials the top contributing sectors
- The Ralton Smaller Companies Portfolio made a solid gain of 1.41%, outperforming the benchmark by 0.50%
- The portfolio's Industrial and Consumer Discretionary stocks added to portfolio returns for the month, offset to some degree by our underweight exposure to Financials

Portfolio Commentary

Monthly Performance Attribution

Top Contributors	Positioning	Key Detractors	Positioning
Blackmores Limited	Overweight	Austbrokers Holdings	Overweight
Auckland Intl Airport	Overweight	iSelect Limited	Overweight
Nufarm Ltd	Overweight	Beach Petroleum	Overweight

Positive Contributors

Vitamin manufacturer and distributor Blackmores Limited (BKL, +14.7%) was the portfolio's top contributor for the month, boosted by a profit upgrade in January. Specifically, BKL have delivered a 22% rise in sales and 50% increase in profit for the first half of the financial year - further details to be announced as part of the company's half-year profit release in February. These results vindicate our view that industry dynamics for the vitamin segment in Australia have significantly stabilised during the last 12 months, in part due to less discounting and promotional spending from competitor, Swisse. BKL have a small, but growing, presence in Asia, and we believe that over time several of these markets, including Korea, Thailand, Singapore and Malaysia, could become material to the BKL group.

Auckland International Airport (AIA, +6.7%) was also a strong performer for the month. Auckland airport is the major entry point for flights into New Zealand (NZ) and thus a very strong indicator of passenger movements in and out of NZ. Airport traffic has benefitted in recent times from the strength of the NZ economy, growth in low cost carriers across the region, and the strong demand from Asian tourists to visit NZ. China has been a particularly strong contributor to the growth in visitation, with the airport continuing to sign new carriers and flights from China on a regular basis. From an investor perspective the share price has benefitted not only from the demand growth in passenger services, but also the attractiveness of infrastructure assets that pay an attractive, growing dividend. Low bond yields globally make the dividend yield of AIA attractive and also drive down the cost of borrowing and the implied value of the airport, both of which have boosted not only the share price of AIA, but infrastructure assets broadly.

Global crop protection specialist Nufarm Ltd (NUF, +20.0%) continued its recent business and share price momentum. Nufarm has made considerable progress in restructuring and refocusing the business following a period of time where profit forecasts were missed, debt rose, and oversupply of one of NUF's key products, glyphosate, rattled investors and the share price in turn. The Nufarm of today is a far more diversified business, by product, region and market segment. The business has a strong product offering across a range of crops and crop protection chemicals. NUF also has considerable and growing exposure to complimentary business lines, including 'turf' and 'seeds.' Instead of profits being derived largely from Australia - and prone to the whims of Australian rainfall – NUF now has more than 70% of profits derived elsewhere, and profit sources spread relatively evenly across South America, North America, Europe and Asia. These changes, together with recently announced cost savings and debt reduction targets across the group, are being well received by investors.

Underperformers

Austbrokers Holdings (AUB, -13.1%) weakened after a profit downgrade and was the key negative contributor to the portfolio in January. AUB is focused on insurance broking and has ownership stakes (typically majority stakes) in a network of insurance brokers across Australia who offer a range of insurance services to clients, largely SME type businesses. AUB make profits from the underlying broker businesses, but also profit from offering a range of services to the broker businesses. January's profit downgrade was driven by a rapid fall in insurance premiums across the balance of calendar year 2014, which of course flows through to AUB's commissions and profits. AUB has delivered very steady profit growth since listing, driven by organic growth in the commissions generated from it's network, augmented by ongoing consolidation efforts, adding brokers to its network. At this stage, we are seeking to ascertain the future direction of premium trends in the market and how this will impact AUB before making a decision either way on our AUB investment.

iSelect Limited (ISU, -5.1%) also detracted from returns, declining in a rising market. Our investment thesis for ISU is that the company is capable of capitalising on its position as a premier provider of online comparison websites. ISU has a very strong offering in Health Insurance, however we believe the company can use its brand to build out its offering in a series of consumer verticals, such as Energy, Life, and Car Insurance. Since listing, ISU has attracted negative attention due to changes in management and board responsibilities, however with these distractions now in the past we are looking for the company to generate returns for shareholders on the basis of the quality of the underlying business.

The weakness in the oil price – which we have discussed in prior reports – continued to impact our holding in Beach Petroleum (BPT, -8.1%) in January. BPT own a series of solid, mid-tier production assets, with a strong pipeline of development opportunities. BPT remain profitable, even with the large fall in the oil price. Subsequent to month's end it appears that BPT's approximately 50% share price fall since mid 2014 has attracted corporate investor interest. Kerry Stoke's Seven Group Holdings (SVW), whose CEO is ex Woodside CEO Don Voelte, has acquired a 13.8% stake in BPT. SVW own significant investments in Seven West Media (SWM), Caterpillar franchise Westrac, and recently have been acquiring assets in the Energy sector.

Portfolio Adjustments

During the Month we...

SOLD: Nil

BOUGHT: Nil

Portfolio Adjustments

There were no portfolio changes during the month.

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

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For Further Information

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