Total returns

At 31 December 2017	1 mth %	3 mths %	6 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	Inception % p.a. (Feb 2008)
Ralton Smaller Companies	3.30	10.29	10.62	15.07	14.75	15.30	12.90	9.03
Income return	*0.13*	*0.27*	*1.33*	*2.61*	*2.91*	*3.22*	*3.51*	*3.75*
Growth return	*3.18*	*10.02*	*9.30*	*12.46*	*11.84*	*12.09*	*9.39*	*5.28*
S&P/ASX Small Ord Accum. Index	3.20	13.69	18.70	20.02	14.38	7.39	2.59	1.54
Difference	**0.10**	**-3.40**	**-8.07**	**-4.95**	**0.37**	**7.91**	**10.31**	**7.49**

Performance review

- The S&P/ASX Small Ordinaries Accumulation Index performed strongly in the December quarter, adding 13.69%, with strong gains from Materials, Health Care and Energy sectors.
- The Ralton Smaller Companies portfolio returned 10.29% for the quarter, underperforming the benchmark by 3.40%.
- The portfolio's underweight exposure to Materials, largely the metals and mining sub-segment, together with the portfolio's cash holding in a rising market were the key detractors from portfolio performance. Stock selection within Industrials, Information Technology and Telecommunication Services each added clear value to the portfolio.

Performance attribution

The Ralton Smaller Companies portfolio has underperformed the market over the past six to twelve months. Although this is very frustrating, it has largely been driven by stocks which fall outside of our investment universe. The underperformance is largely covered by:

- Our non exposure to the "EV battery" stocks. There is a view the move to electric cars will create massive demand for lithium, cobalt, copper and nickel for use in batteries sometime in the 2020's. We are skeptical around this story – 5 years ago there was going to be untold demand for copper as China moved its car fleet to hybrids (which never eventuated). Further, the criteria we normally apply for an investment in resource companies were not met by the lithium and cobalt miners in our universe. Not being invested in these stocks has cost us approximately 2.50% over the past year.
- Our not holding a position in A2 Milk (A2M). This cost us some 2.5% of performance over the period. We did not hold this stock and absolutely acknowledge the execution of management in terms of product supply and marketing capability. We would however highlight solid returns for the portfolio from various agriculture and "Chinese consumer" stocks such as Costa Group (CGC) and Blackmores (BKL) across the period.

We will continue to follow our process for generating above market returns which has worked over the past 10 years.

Key contributors

Key contributors	Positioning
Beach Petroleum	Overweight
Nextdc Limited	Overweight
Speedcast International Ltd	Overweight

Beach Petroleum (BPT, +53.4%) – BPT shares made further gains in the quarter, supported by a solid quarterly production report, stability in the oil price and likely investor comfort with the recent operational $1.57bn acquisition of Lattice Energy, the upstream oil and gas assets of Origin Energy (ORG), The assets include several key stakes in Australian focused oil and gas fields, including the Waitsia development opportunity in WA. With BPT themselves having succeeded in simplifying and operating its own assets, reducing drilling costs and the like, the opportunity now exists for BPT to leverage this opportunity and seek to reduce costs across the Lattice business, something that ORG, with all its other corporate distractions was less focused on.

The Lattice gas producing assets typically have medium term offtake agreements with various energy retailers, priced it appears around $6/GJ. In future years, based on current market dynamics, these contracts are likely to reprice higher, providing upside to the assumptions that BPT took on as part of the deal. In the short term, BPT will be focused on using the steady cash flows from Lattice and its other oil and gas assets to reduce the debt levels associated with the debt that BPT took on. We are comfortable with the debt levels, but like most investors will be keen to see BPT reduce the debt rapidly toward its 2019 gearing targets.

Nextdc Limited (NXT, +37.6%) – long term portfolio holding and data centre owner and operator NXT was again a strong contributor to portfolio returns in the

December quarter. The stock is now up almost 65% rolling year. NXT is in both an execution and growth phase, specifically signing up and connecting customers to use its existing data centres and building out new capacity for further data centres in Australia's major cities. The thematic of rising data usage and need for this data to be stored and accessible in a safe and secure manner is incredibly strong with opportunities like cloud computing remaining in it's relative infancy. Behind this 'digital and data' theme, the business model for NXT relies on acquiring and building electronic storage.

Barriers to entry are high, as you would expect, and NXT now appears to have reached critical mass in terms of customer growth, number of centres and capital sustainability. We like the exposure NXT offers to the growth in demand for data, cloud computing and associated technology services and still believe it offers good value over the medium term. The potential exists for NXT to double or more the size of its currently planned data centres, subject to demand, execution and the market remaining rational.

Speedcast International (SDA, +34.7%) – shares in satellite communications provider, SDA rallied in the quarter, buoyed by confidence in the near term outlook for SDA from recent investor presentations. Investors have been concerned about company debt levels, integration risk from acquisitions made in the last two years, and weakness in demand for satellite services in the energy sector. Investors will recall that SDA's largest acquisition, that of Harris Caprock (HC), is focused almost solely on Energy customers. This sector has been hit heavily by oil price declines over 2015 and 2016 as well as the subsequent pull back in demand for offshore and remote area services as production and capex downturns have impacted the industry. Pleasingly, recent investor briefings have sought to highlight successful integration and synergies delivered from acquisitions (HC, Ultisat, NewCom International), improving trends in the energy sector and indeed, all segments. Successful execution on integration and obtaining the company's stated profit targets will reduce concerns around debt levels and gearing. The shares are up nearly 50% since the August full year results, reflecting investor's increased conviction levels in relation to SDA.

Key detractors

Key detractors	Positioning
Ainsworth Game Technology	Overweight
iSelect Ltd	Overweight
Tassal Group Limited	Overweight

Ainsworth Game Technology (AGI, -15.3%) – turnaround investment AGI lost ground in the quarter as cautious outlook commentary at the AGM and management's discussion, pointing to a second half bias in profits for FY18 saw the shares fall across the month. At a regional level, operating results have been mixed, with Australia remaining close to bottom of cycle, but no clear sign of a rebound in market share. In one sense, this feels somewhat like last year when the company highlighted a second half bias toward earnings. Ultimately they met this guidance and although the recent AGM commentary was disappointing in the short term we do believe that the turnaround initiatives that we have described previously remain broadly on track.

iSelect Limited (ISU, -10.3%) – ISU's shares underperformed in the quarter, continuing the negative pattern since an underwhelming FY17 profit result in August. News that well regarded CFO Daryl Inns had, in November resigned with immediate effect due to health reasons further rattled investors and the share price in turn. Despite this backdrop our discussions with the company confirmed that the CFO had resigned for genuine health reasons. Further, ISU recently provided FY18 profit guidance at its AGM, confirming an outlook that was both in line with our expectations and further, provided good detail in terms of divisional expectations and the like. We look to the coming year to confirm the growth opportunities in non-health verticals as outlined in ISU's detailed guidance. As such we took the share price weakness as an opportunity to add to our ISU holding.

Tassal Group (TGR, -2.3%) – one of the portfolio's larger holdings, salmon producer Tassal Group weighed on portfolio returns during the quarter against a rising market. There was no company specific news flow of note, during the period, although we note that global salmon pricing (where TGR sell some 15% of it's fish) has fallen from peak levels in recent months. Our investment thesis for TGR is focused on the thematic that consumers will continue to be attracted to salmon as a healthy source of affordable protein. Demand growth has been strong domestically for many years and in Asia, consumers are motivated by the option of eating Tasmania's salmon and the 'large' fish that TGR grow with a view to Asian markets. TGR continue to invest in fish stock, production equipment and aquaculture facilities in a controlled, measured and sustainable manner. With rising scale we expect TGR to benefit in terms of margin in coming years and believe the share price remains attractive at these levels.

Portfolio changes

Key additions and material adjustments

We added several new stocks to the portfolio in the quarter.

Bought
Aveo Group (AOG)
Cooper Energy (COE)
Healthscope Limited (HSO)
Primary Healthcare (PRY)

The Aveo Group (AOG) is one of Australia's largest owner operators of aged care facilities and retirement homes. The company was recently the focus of a TV review, heavily critiquing the nature and terms of AOG's contracts, including the sale and lease back terms for AOG residents. We accept that aged and retirement care is a contentious and emotive topic and that respectful and dignified treatment of people in their final years is vital. Although we are loath to comment on the journalism per se we are comfortable to highlight that the company's conduct and contract terms appear both within the bounds of industry standard and further, that AOG's conduct and strategy has, in our eyes seen AOG maintain its social license to operate.

With some expectation of a negative operating impact from the TV report, the stock has traded down heavily. The discount to NTA or net tangible assets was material and we elected to begin buying the stock. We believe that government has a mostly supportive view of the industry fee structures and highlight the necessity of current private contributions to the overall challenge of funding health and aged care. Regulation of some sort is always possible, and in this context we do note the pending ACCC review of the industry structure. We would be surprised to see material changes as to how aged care and retirement living is funded or regulated, although cannot rule this out entirely.

Cooper Energy (COE) is a SA based gas producer set to benefit from rising gas prices on the east coast of Australia. Although COE have some small producing assets the company's key asset is the Sole gas field, currently in development, with first commercial gas due in 2019. CEO David Maxwell and his team have made significant progress at COE, simplifying and focusing the business via asset sales and positioning the business for growth via the acquisition of the Sole project. Advancing Sole has required several capital raisings, which have somewhat dented investor enthusiasm in the short term. We expect that delivery of the project on time and budget will see investors focus on the cash flows that come from high margin gas sales to top tier customers.

Healthscope Limited (HSO) – We added Australia's number 2 hospital operator to the portfolio in October. The stock was relisted via IPO in mid 2014. The share price rallied circa 50% at its peak before recently reverting toward the IPO price, and we now view the valuation as more interesting. Recent concerns included the exit of long standing CEO Rob Cooke and a slow-down in hospital admissions during FY17 which coincided with HSO bringing more bed capacity onto the market. Broader economic driven affordability concerns for private health insurance (PHI) also weighed on the stock. We expect this to cap PHI participation in years to come, although expect that the core of HSO's patients, the 50 plus demographic, will attempt to maintain PHI to ensure access to preferred hospitals and surgeons. On this basis, and assuming that HSO can grow admissions around 2-3% per annum, we see HSO as reasonable value over the medium term.

Primary Healthcare (PRY) – PRY is one of Australia's largest healthcare service providers, supporting GP clinics, dentistry, radiology and pathology. In recent years with several changes in senior management, limited financial flexibility from a balance sheet perspective and a somewhat disjointed strategic effort and business mix, PRY has struggled to grow profits and returns for shareholders. With new CEO, Dr Malcolm Parmenter joining PRY, having successfully led Sonic Healthcare's GP division, we have a more positive view on PRY and see solid turnaround potential. In particular, we expect that a series of operational initiatives and modest capital investment can drive improved patient service, GP satisfaction and profitability of the medical clinics in turn. PRY's other divisions appear in better shape, although each will benefit from various operational tweaks and a new set of eyes at the CEO level. PRY has underinvested across each of its businesses for several years and hence some catch up capital is required. This by itself will limit free cash flow for a couple of years, however we would highlight that changes to the upfront payment model for GPs – which created its own accounting issues in years prior – will be a driver of improved cash flows and an offsetting factor at a group level.

Key disposals and material adjustments

Sold
Macquarie Atlas Roads (MQA)

Macquarie Atlas Roads (MQA) – We elected to sell our long held position in MQA during the quarter. MQA shares had rallied to an all-time high, following the recent capital raise to the support the purchase of an additional 4.9% in the APRR toll road network. News that long time CEO, Peter Trent, was set to resign in February 2018, replaced by James, Hooke, current CEO of Macquarie Infrastructure Corporation was also well

received by the market. Trent has been integral to the restructure, simplification and now expansion of MQA in the last eight years. With the commensurate reduction in yield for MQA securities and the stock trading at what we felt was fair value we took the opportunity to exit our holding in MQA.

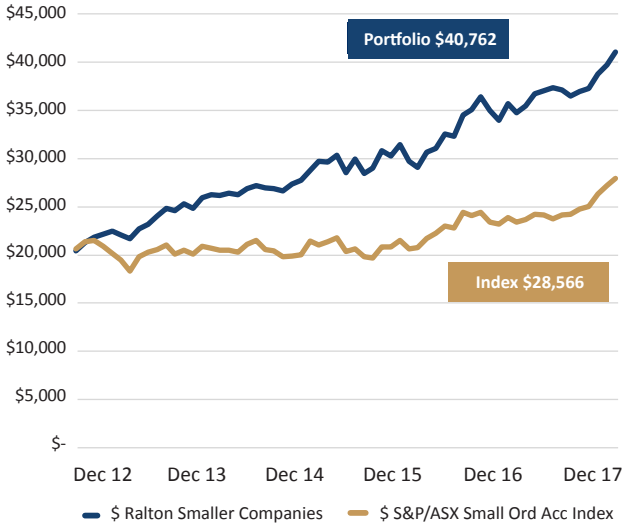
Sector allocation

GICS sector	Ralton	Index	+/-
Health Care	14.5%	6.4%	8.1%
Telecommunication Services	5.6%	1.8%	3.8%
Energy	8.8%	6.8%	2.0%
Utilities	2.2%	0.5%	1.6%
Financials	9.6%	8.0%	1.6%
Materials	16.9%	17.8%	-0.9%
Consumer Staples	10.1%	11.3%	-1.2%
Information Technology	5.5%	7.4%	-1.9%
Real Estate	9.9%	12.0%	-2.0%
Industrials	7.0%	9.3%	-2.3%
Consumer Discretionary	10.0%	18.7%	-8.7%
Total	**100.0%**	**100.0%**	**0.0%**

Top 10 holdings#

Company name	ASX code
Worleyparsons Limited	WOR
Tassal Group Limited	TGR
Nufarm Limited	NUF
Beach Energy Limited	BPT
iSelect Ltd	ISU
Healthscope Limited	HSO
Pact Group Holdings Ltd	PGH
Nextdc Limited	NXT
OFX Group Ltd	OFX
Skycity Entertainment Group Ltd	SKC

Performance comparison of $20,000*



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Performance of the Ralton Wholesale Smaller Companies Model Portfolio is based on a model portfolio and is gross of investment management and administration fees, but net of transaction costs. The total return performance figures quoted are historical and do not allow the effects of income tax or inflation. Total returns assume the reinvestment of all portfolio income. Past performance is not a reliable indicator of future performance.

*The performance comparison of $20,000 over 5 years is for illustrative purposes only. Performance is calculated on a gross basis. Actual performance will vary depending on the amount of fees charged by the relevant platform that a client uses to implement the portfolio. The comparison with the S&P/ASX Small Ordinaries Accumulation Index is for comparative purposes only. Index returns do not allow for transaction, management, operational or tax costs. An index is not managed and investors cannot invest directly an in index. There is no guarantee these objectives will be met.

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