Ralton Smaller Companies
PERFORMANCE REPORT
31 March 2016

Total returns

At 31 March 2016	1 mo. %	3 mo. %	1 yr. %	2 yr. p.a. %	3 yr. p.a. %	5 yr. p.a. %	7 yr. p.a. %	Inception p.a. (Feb 2008) %
Ralton Australian Shares	5.53	-2.48	3.20	8.35	11.77	10.60	15.79	7.12
Income return	*1.07*	*1.14*	*3.17*	*3.18*	*3.51*	*3.63*	*3.75*	*3.80*
Growth return	*4.46*	*-3.62*	*0.03*	*5.17*	*8.26*	*6.97*	*12.04*	*3.32*
S&P/ASX 300 Accum. Index	5.47	1.03	3.72	3.01	1.50	-2.08	7.09	-1.75
Difference	**0.06**	**-3.51**	**0.52**	**5.35**	**10.27**	**12.68**	**8.70**	**8.87**

Performance review

- The S&P/ASX Small Ordinaries Accumulation Index gained 1.03% in the March quarter, boosted by strong performance from the Materials sector, particularly gold stocks and to a lesser extent, Telecommunications.
- The Ralton Smaller Companies portfolio fell 2.48% for the quarter, underperforming the benchmark by 3.51% for the period.
- Our underweight position in Materials, together with poor performance from our Consumer Discretionary names, contributed to the portfolio's underperformance.

Performance attribution

Key contributors

Key contributors	Positioning
Independence Group (IGO)	Overweight
Costa Group Holdings (CGC)	Overweight
Macquarie Atlas Roads (MQA)	Overweight

Macquarie Atlas Roads (MQA, +17.8%) - shares in the toll road owner added value in the March quarter, following both solid performance from MQA's core assets, together with the potential for corporate activity at an asset level. MQA's key toll road, APRR in France, was a beneficiary of solid growth in traffic, particularly the higher-fee-paying heavy vehicles or trucks. Growth in truck movements suggests some strength in the French economy, particularly the industrial base. On the corporate front, MQA indicated that it has right of first refusal when its partners, including Macquarie 'sister funds', complete the tender process for their stake in Dulles Greenway. MQA could potentially acquire 100% of this asset, however in the current environment it seems more likely it will sell its stake to the highest bidder. In all likelihood, this capital will be returned to shareholders in some form.

Greencross (GXL, +6.7%) - shares in the veterinary and pet retail business were supported by strong half-year profit results together with corporate activity, with ongoing interest from private equity groups in acquiring a parcel of shares or even the business outright. One such group had attempted unsuccessfully to acquire a 15% stake in GXL in December last year. We have followed a number of global pet service businesses and note the solid growth and insatiable demand for rich countries to spend on their pets. Despite recent management changes at GXL and an aggressive expansion strategy, which has seen GXL increase its debt levels to fund inventory and store roll-outs, we have continued to back this investment in the medium term. For these reasons it appears that private equity and other investors are also showing interest. The first-half results were very solid with strong sales, profit growth and early success from co-location of veterinary and retail stores evident in these figures. Cash flow was much improved, an issue which had been scratching the dog for some time.

IRESS Limited (IRE, +16%) - shares in the financial markets and information service provider rallied strongly after a solid full-year profit result for FY15. IRESS has expanded beyond its Australian roots and now provides services in Asia, Canada, South Africa and the UK. Some of these regions have to date had only a modest return for shareholders or been slow to hit expectations that either the market or the company had set. In 2015, the profit result of the UK division was very strong and exceeded market expectations, including a notable shift toward IRE's 'recurring revenue' model. In the UK, IRE is attempting to replicate the success of its Wealth Management (WM) division in Australia. This division again delivered strong results for the period. The UK wealth management market is far larger than Australia and competition is less intense it seems. Despite the strong result, we took the opportunity to take profits in IRE given the share price movement and the history of previous 'slow progress' in this market.

Key detractors

Key detractors	Positioning
Super Retail Group (SUL)	Overweight
Billabong (BBG)	Overweight
New Hope Corporation (NHC)	Overweight

Super Retail Group Ltd (SUL, -25%) - profit results for the first half of FY16 disappointed overall expectations with the group's leisure businesses, BCF and Ray's, disappointing investors. BCF was the key negative as its offering was not competitively priced versus its main competitor, leading to weak sales in the key pre-

Christmas months of November and December. Both the auto and sports divisions produced very solid results exceeding most market forecasts, but this was not enough to offset the weakness in leisure. SUL's management has identified strategic shortfalls in the sales program for BCF and has taken steps to improve delivery and ensure sales momentum is not lost in the key sales window again. Early results are positive with strong sales growth highlighted in January and February, yet despite this, we remain cautious on this division and frustrated that management continues to fail to get to grips with its diverse array of businesses.

Billabong (BBG, exited) - shares in the surf retailer fell heavily across the quarter with recent sales weakness in the US a key feature. Having bought into BBG as an advancing turnaround play, we have been disappointed with the sales results in recent months, for both BBG and the broader street or leisure wear industry. Sales pressure, particularly in the US, has likely been impacted by one-off events such as port strikes impacting inventory; however, at a time when BBG is still looking to pay down debt and grow margins, the timing has been poor. As a result, we took a cautious view and exited the position. We will revisit BBG when we have more confidence in the direction of the turnaround and once the risks to delivery have reduced.

New Hope Corporation (NHC, -29%) - although only a small position in the portfolio, the fall in NHC shares weighed on returns for the period. NHC recorded a small profit from the operation of its QLD-based Acland mine in the recent profit results. The company also completed the acquisition of RIO's stake in the Bengalla coal mine, a high quality coal asset that is still profitable in the current low coal price environment in which many mines are struggling. Despite these achievements, the headwinds of the coal sector continue unabated. At this juncture, and perhaps with a disappointing outlook in terms of costs and mine control at the Bengalla asset, we have elected to sell our holding in NHC with a view to revisit this investment once we have more clarity around the future direction of the coal price. Some capacity has come out of the global market, however production is certainly proving sticky.

Portfolio additions and disposals

Key additions and material adjustments

Bought
Orora Limited (ORA)
EQT Holdings (EQT)

We added two new stocks to the portfolio, together with adding to several of our existing holdings, including MQA, TGR and CGC.

Orora Limited (ORA) - we added ORA back to the portfolio following a pull-back in the share price. Since the demerger from Amcor (AMC) in December 2013, ORA's profit growth has been delivered from self-help initiatives largely focused on its Australian operations devoted to Australian-oriented packaging, bottles, cans and paper/ fibre packaging. The US side of the business provides ORA with growth opportunities given the marketplace is more fragmented than in Australia. In the near term, we expect US sales to approach 50% of ORA's total sales.

With internal self-help initiatives almost completed, ORA is shifting towards a more active investment phase with two recent announcements involving approximately $150m of committed spending. Firstly, the company decided to expand glass manufacturing capacity at Gawler in South Australia to meet growing demand for bottled wine – linked to the weakening Australian dollar – and secondly, ORA acquired IntegraColor, a specialist US-based packaging business. Given its track record to date, we have a supportive view of ORA's management and its decision to invest these funds to grow the business and meet its own investment hurdles.

EQT Holdings (EQT) - following recent market disappointments and share price weakness, we added a small position in EQT to the portfolio. EQT is a financial services company offering a broad range of customer solutions, although the company's broad expertise and barriers to entry focus on estate planning, private wealth services and philanthropy. EQT also provides corporate fiduciary services, such as RE or responsible entity, and manages and oversees various estates and trusts on behalf of individuals and organisations such as charities. Clients tend to be long-standing, often remaining clients well beyond their death. The recent market disappointments are effectively a downgrading of profit expectations, principally attributed to rising costs across the business. The share price response has been quite severe and with the company highlighting that many of the cost increases are one-off or will reduce in time as new initiatives deliver efficiency gains, we have begun to build a small position in the stock. We highlight the attraction of the company's assets and the long-dated nature or tenure of its clients.

Key disposals and material adjustments

Sold
Sky City Entertainment (SKC)
Navitas Limited (NVT)
Myer Holdings Ltd (MYR)
AWE Ltd (AWE)
G8 Education (GEM)
Henderson Group (HGG)
New Hope Corporation (NHC)
Billabong (BBG)

There were several outright sales from the portfolio during the quarter, reflecting the exit of some successful investments, together with the sale of several underperforming stocks where our expectations for company delivery were either not met, or our ongoing research led to a change in views. BBG, IRE and NHC have already been discussed.

Sky City Entertainment (SKC) - a profit upgrade from the company in January was well received by the market and allowed us the opportunity to take profits and sell our position. SKC continues to operate well with favourable tailwinds in the form of the Auckland economy and rising tourism into NZ, supported by a strong management team leading the key casino asset in Auckland to report strong profit growth. However, with SKC about to embark on significant capital expenditure and projects in both Auckland and the smaller Adelaide asset, which continues to struggle from an operational perspective, our view was to take profits and watch for a potential cheaper entry point in the future.

Navitas Limited (NVT) - we elected to sell our holding in education provider, NVT. The shares have performed strongly in recent times in a weak market. Although the company is making headway in terms of improved profitability of the smaller SAE division and continues to grow its college offering offshore, the headwinds from the loss of a key Sydney contract appear to be proving harder to offset at the profit line. By itself, our sense was that this longer time frame was acceptable as an investment proposition, however the prospects for emerging markets and key education source countries have worsened. Although families frequently sacrifice most items for their children, we are concerned the coming periods may see education demand from the emerging markets temper and a flow-through impact on NVT's outlook. Given the valuation and recent performance, we elected to sell, although NVT will remain on our investment radar.

Myer Holdings Ltd (MYR) - in the retail segment, we elected to sell our position in Myer Holdings. To recap, new CEO, Richard Umbers, appears to have made good progress in the turnaround of MYR, including, as we highlighted previously, the stronger balance sheet and the move by MYR to boost concessionaire space within its stores. With some progress being made and the share price performance beginning to better reflect this, we made the decision to exit MYR. We also flag the headwind that the retail sector faces in coming months with a mid-year election appearing likely, triggering what is often a headwind to trading, consumer confidence and spending patterns in general.

AWE Ltd (AWE) - we sold our holding in energy company AWE. AWE is asset rich with a range of mid-quality producing oil and gas assets and future investment opportunities. However, the decline in oil prices has impacted both the profitability of AWE's assets, the viability of developing key projects in terms of funding capability and the economic returns, and finally the share price. With AWE able to sell its 10% holding in the Sugarloaf project for US$190m – its hand was somewhat forced by the oil price declines – we took the share price rally as an opportunity to exit our position.

G8 Education (GEM) - despite some solid progress around governance, including a new Chair, auditor appointment and reasonable operating conditions, we remain concerned about financing risk for GEM. We have provided management ample time to resolve this and in the current climate, we believe the refinance risks are rising. Further, the exit of CFO, Chris Sacre, to take on a consulting role for the development and sale of childcare assets back to GEM raises some questions as to corporate governance.

Henderson Group (HGG) - finally, we took profits in our holding in UK-based fund manager, HGG.

Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Staples	18.0%	8.5%	9.5%
Industrials	14.7%	10.6%	4.2%
Consumer Discretionary	27.2%	23.5%	3.8%
Health Care	11.1%	7.5%	3.6%
Telecommunication Services	2.5%	1.5%	1.1%
Financials (ex-Property)	7.4%	7.9%	-0.4%
Utilities	0.0%	0.7%	-0.7%
Energy	1.8%	3.5%	-1.7%
Materials	14.2%	16.8%	-2.5%
Information Technology	0.0%	7.3%	-7.3%
Property	3.0%	12.4%	-9.4%
Total	100.00%	100.00%	

Top 10 holdings#

Company name	ASX code
Macquarie Atlas Roads Group	MQA
Fisher & Paykel Healthcare	FPH
Pact Group Holdings Ltd	PGH
News Corp.	NWS
Sky Network	SKT
Ardent Leisure Group	AAD
Aristocrat Leisure	ALL
Tassal Group Limited	TGR
Orora Limited	ORA
Fletcher Building	FBU

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[#] Portfolio holdings may not be representative of current or future recommendations for the portfolio. The securities listed may not represent all of the recommended portfolio's holdings. Future recommended portfolio holdings may not be profitable.