RALTON
ASSET MANAGEMENT

Ralton Australian Shares

PERFORMANCE REPORT

31 July 2016

Total returns

At 31 July 2016	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 Australian Shares	5.83	5.97	12.30	2.38	11.48	12.77	11.09	7.19
Income return	*0.05*	*1.31*	*2.67*	*4.73*	*4.19*	*4.34*	*4.32*	*4.39*
Growth return	*5.78*	*4.66*	*9.62*	*-2.35*	*7.29*	*8.43*	*6.77*	*2.80*
S&P/ASX 300 Accum. Index	6.36	7.02	13.87	2.85	8.06	9.38	8.54	4.30
Difference	**-0.53**	**-1.04**	**-1.58**	**-0.47**	**3.42**	**3.39**	**2.55**	**2.89**

Performance review

- Markets started the FY17 financial year in strong fashion, with the S&P/ASX 300 Accumulation Index recording a 6.36% gain. All market sectors were positive with Consumer Staples and Consumer Discretionary both adding more than 8%.
- The Ralton Australian Shares portfolio made a strong gain of 5.83% for the month, although underperformed the benchmark by 0.53%.
- For the month, being overweight Consumer Discretionary and Consumer Staples added value to returns, however our underweight to Materials, and stock selection within this sector, each weighed on relative performance.

Performance attribution

Key contributors

Key contributors	Positioning
Aristocrat Leisure Limited (ALL)	Overweight
Macquarie Atlas Roads (MQA)	Overweight
Woolworths Limited (WOW)	Overweight

Aristocrat Leisure (ALL, +15.5%) – again added material value to the portfolio as share price momentum continued into July. This followed the company's profit upgrade in June and a strong presence in the Goldman Sachs Annual Slot survey during July. As we highlighted last quarter, the profit upgrade was driven by a number of factors including market share gains in Australia and North America, continued growth in participation gaming machine installations (annuity-style income) and further stellar growth in the Digital division. This growth reflects the continued investment in product by ALL. Looking forward, we believe ALL's operating momentum should continue while its main peers remain distracted by their own large-scale acquisitions. With a strong balance sheet and free cash flow, ALL has the option of increasing distributions or making another acquisition. We are comfortable with ALL pursuing acquisitions given its success integrating VGT and Product Madness.

Shares in **Macquarie Atlas Roads (MQA, +12.4%)** rose in July, as did many other 'bond-sensitive' stocks. This was driven by lower long rates (global bond yields for 10-year sovereign bonds) following the Brexit vote and speculation of further easing in monetary policy globally. MQA announced its traffic volume and revenue for the June quarter, reporting solid growth for each of its key roads, the APRR in France and Dulles Greenway in the US. MQA and Macquarie Bank, the manager of the vehicle, have also agreed to revise the base management fee, resulting in savings to MQA of approximately $14m per annum.

Woolworths Limited (WOW, +12.1%) – our investment in corporate turnaround WOW added value to the portfolio in July following a well-received market update. From our perspective, the key message from the update was an improvement in sales momentum in volume terms in June and July. This comes after an investment of approximately $1bn in reducing prices and improving customer service. The group also has new concept stores in operation where they are trialing new formats. We will be looking for continued improvement in key sales metrics and expect to hear more on store refurbishment plans over the next six months. The success of these new store formats in driving higher sales and the pace of the roll-out of the refurbishments will be critical to sales improvement. Several substantial write-offs were announced as part of CEO Banducci's strategic review, including a provision to cover the closure of a number of unprofitable stores across the supermarkets and Big W networks. There are numerous other moving parts in this major turnaround and it is still relatively early days, so we will continue to carefully monitor the changes coming through. This turnaround story will likely take another four to five years to play out.

Key detractors

Key detractors	Positioning
Computershare Ltd (CPU)	Overweight
Origin Energy Ltd (ORG)	Overweight
Incitec Pivot (IPL)	Overweight

Computershare Limited (CPU, -3.2%) – the success of the 'leave' vote in the UK Brexit referendum saw heavy selling in financial stocks extend from June into July. For CPU, there are two key impacts: (1) CPU's UK operations will see a translation headwind given the decline in the pound, and (2) interest rates globally have eased again during July as expectations rose of a substantial monetary easing by the Bank of England and the ECB. CPU is exposed to declines in interest rates as it earns part of its income from the earnings on its substantial cash balance.

Origin Energy (ORG, -4.4%) – ORG retraced some of its recent share price gains during July after the oil price weakened again (down 14% for July). ORG's share price will continue to move with the oil price to a degree, however we believe ORG has made good progress on several fronts. Since the capital raise in September 2015, ORG has shown solid performance from its Energy Markets business, ramped up production at its APLNG plant in Queensland, taken material costs out of the business (particularly the upstream gas assets) and finally, made progress on non-core asset sales as part of an overall debt-reduction strategy. The planned 120-day 'completion test' for the first LNG train is currently underway and once complete, will see debt commitments from the parent ORG group against the APLNG JV reduce materially. We are expecting to see further improvement on each of these fronts at the full-year profit results in August.

Incitec Pivot (IPL, -3.4%) – IPL underperformed in a strong market driven by the rising US dollar and continued weakness in fertilizer prices which flow from rising grain inventories across the globe. On a more positive note, we expect IPL's Louisiana ammonia manufacturing plant will commence operations this quarter. This will be a key event for IPL given capital expenditure will decline and cash flow will rise, which should drive a material inflection point in IPL's return profile. With DAP and Urea prices nearing 10-year lows, we expect IPL to make reasonable returns from the fertilizer business given its position on the cost curve.

Portfolio changes

Key additions and material adjustments

Bought
AGL Ltd (AGL)
Santos (STO)
Cleanaway (CWY)

There were several new stock additions to the portfolio in the month, each of which is discussed below.

AGL Ltd (AGL) – we added a position in utility company AGL during July. An investment in AGL has three supportive features from our vantage. Firstly, under CEO Vessey AGL has made considerable progress in driving productivity improvements to boost profits. Secondly, the increased use of renewable energy in the electricity markets is driving up the wholesale electricity price to the benefit of low-cost electricity producers such as AGL. Finally, AGL's balance sheet is in good shape after recent asset sales. AGL is well positioned to either return capital to shareholders or alternatively pursue acquisitions. There has been media speculation that AGL is a potential bidder for the assets (both generation assets and the retail business) of WA-based Alinta Energy.

In the energy space we have added a modest position in **Santos (STO)**. STO recently appointed Kevin Gallagher as CEO, who we had followed during his tenure at Clough (an engineering contractor) where he successfully turned around a series of underperforming businesses. He faces a similar task in his new role where the cost structure and culture are impediments to the successful operation of key assets. It appears good progress has been made around parts of the cost structure, with a major business simplification undertaken and more to come. One of his key insights has been that the business was run by too many lawyers! STO has some great assets with the best being the 13% stake in the PNG LNG operation – a world class project with expansion opportunities, operated by Exxon. The Cooper Basin gas fields and GLNG (30% owned by STO) are both good assets, but require further focus on cost reductions to achieve cost-effective delivery and well operation. This should be achievable given what has been achieved elsewhere in the world.

Cleanaway (CWY) – finally, we added the former Transpacific Industries (TPI) back into the portfolio. CWY is an integrated waste company with a footprint that covers waste collection services, landfills and other waste remediation, as well as a series of smaller industrial-linked waste service businesses. New CEO, Vik Bansal, has significant experience running industrial companies and is heavily focused on business simplification initiatives. Critically, we believe CWY can retain the benefits of its cost saving initiatives. Combined with cash flow benefits from lower capital costs as CWY shifts waste disposal to the Melbourne Regional Landfill (MRL), these cost savings will boost profits and support cash flows. Further, we believe the market would be encouraged by CWY using its incremental cash flows to support bolt-on waste acquisitions, which drive the network benefit through scale and direction of waste to company-owned landfill facilities.

Key disposals and material adjustments

Sold
Graincorp (GNC)
Ardent Leisure (AAD)
Woodside Petroleum (WPL)

There were three outright sales from the portfolio during the quarter, discussed below.

Graincorp (GNC) – having already reduced our holding in GNC, we exited the position entirely during July. GNC has re-rated since our acquisition, reflecting a more positive view from the market on the benefits of growth projects in the Oils and Malt divisions. Reasonable recent rains have also improved the outlook for grain harvest and wheat exports. This was largely in tune with our thesis and is now reflected in the higher share price, driving our decision to exit. Going forward, the key piece of uncertainty is the market share that GNC retains in the key east coast export markets in Australia. Should GNC retain or even gain market share in the highly competitive market for export grains, then GNC shares could well justify a higher valuation. However, with no real confidence on this score, we elected to take profits and sell.

Ardent Leisure (AAD) – with a rebound in AAD shares in July, we took the opportunity to exit this position. We have not been able to alleviate concerns that growth in the key US Main Event business is slowing and determine whether the future prospects for Main Event are diminished. A key factor in our reticence to continue to hold the position was management's decision to reduce disclosure around quarterly sales results for Main Event. We will continue to monitor the position, looking for confirmation of a more positive outlook for Main Event or a successful divestment of the domestic Marine assets which would see us reassess our views.

Finally, we sold our position in **Woodside Petroleum (WPL)**. This was principally due to our view that the investment opportunity in STO (already discussed) was a preferable exposure in the energy sector, assuming oil prices stabilise and trend higher over the coming years. WPL management has vigorously and prudently pursued growth initiatives and we note its progress in regard to Wheatstone LNG, NW Shelf back fill and the recent African Oil project acquisition in Senegal. However, in the absence of a meaningful WPL stake in a major growth project such as Browse or Sunrise, the company's growth outlook looks challenging.

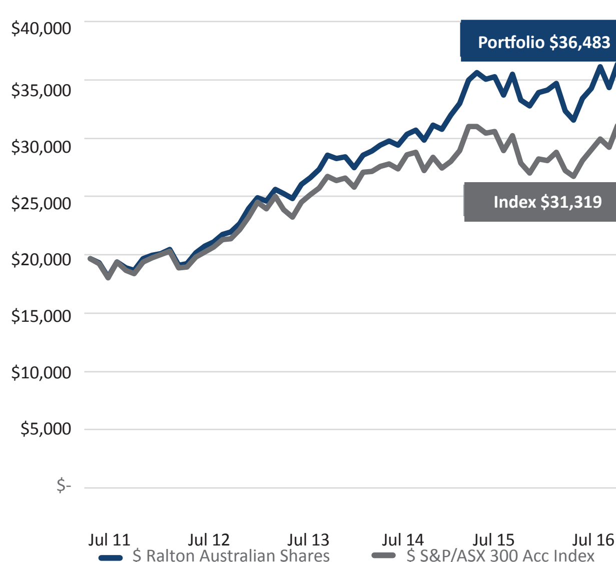
Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Discretionary	12.6%	5.4%	7.2%
Industrials	10.3%	8.1%	2.1%
Information Technology	2.7%	1.2%	1.5%
Health Care	8.3%	7.3%	1.0%
Financials (ex-Property)	36.0%	35.3%	0.8%
Consumer Staples	7.3%	6.9%	0.4%
Energy	4.2%	3.9%	0.3%
Utilities	2.1%	2.7%	-0.6%
Telecommunication Services	4.7%	5.5%	-0.8%
Materials	11.9%	14.3%	-2.4%
Property	0.0%	9.5%	-9.5%
Total	**100.0%**	**100.0%**	**0.0%**

Top 10 holdings#

Company name	ASX code
Commonwealth Bank of Australia	CBA
Westpac Banking Corporation	WBC
Aristocrat Leisure Limited	ALL
National Australia Bank Limited	NAB
Woolworths Limited	WOW
QBE Insurance Group Limited	QBE
CSL Limited	CSL
ANZ Banking Group Limited	ANZ
Macquarie Atlas Roads Group	MQA
Star Entertainment Group Ltd	SGR

Performance comparison of $20,000*



CONTACT COPIA

1800 442 129 | clientservices@copiapartners.com.au | ralton.copiapartners.com.au

John Clothier	General Manager, Distribution	0408 488 549 | jclothier@copiapartners.com.au
Adam Tweedale	State Manager, Southern Region	0425 804 727 | atweedale@copiapartners.com.au
Angela Vincent	State Manager, Northern Region	0477 347 260 | avincent@copiapartners.com.au
Sean Paul McGoldrick	Account Manager, Northern Region	0421 050 370 | spmcgoldrick@copiapartners.com.au
Iain Mason	Director, Institutional Business	0412 137 424 | imason@copiapartners.com.au
Jacinta King	Business Development Associate	0413 962 922 | jking@copiapartners.com.au

Performance of the Ralton Wholesale Australian Shares 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 300 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.

#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.

This document is for general information only and does not take into account the specific investment objectives, financial situation or particular needs of any specific reader. As such, before acting on any information contained in this document, readers should consider whether the information is suitable for their needs. This may involve seeking advice from a qualified financial adviser. Ralton Asset Management (AFSL 298210, ABN 45 114 924 382) (Ralton) is the provider of the Ralton Wholesale Australian Shares Model Portfolio. To subscribe, contact Copia Investment Partners Ltd (AFSL 229316, ABN 22 092 872 056) (Copia) by calling 1800 442 129 or email clientservices@copiapartners.com.au. Any opinions or recommendations contained in this document are subject to change without notice. Ralton and Copia are under no obligation to update or keep information contained in this document current.