Ralton High Yield 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 High Yeild Australian Shares	5.96	6.43	10.93	1.42	11.14	13.76	11.59	7.56
Income return	*0.13*	*1.66*	*3.11*	*5.37*	*4.89*	*4.99*	*4.88*	*4.99*
Growth return	*5.82*	*4.77*	*7.81*	*-3.96*	*6.24*	*8.77*	*6.70*	*2.57*
S&P/ASX 300 Accum. Index	6.36	7.02	13.87	2.85	8.06	9.38	8.54	4.30
Difference	**-0.40**	**-0.58**	**-2.95**	**-1.43**	**3.08**	**4.37**	**3.05**	**3.26**

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 High Yield portfolio finished the month up 5.96%, underperforming the benchmark by 0.40%.
- 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, both 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
Incitec Pivot (IPL)	Overweight
Computershare Limited (CPU)	Overweight
SAI Global (SAI)	Overweight

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.

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.

SAI Global (SAI, -2.7%) – SAI underperformed in a strong market as investors question the direction the company is taking. There has been ongoing speculation about a private equity offer for the whole business. However, during the month, SAI announced they had received an expression of interest from outside parties in acquiring SAI's Assurance division. The company subsequently confirmed it was starting a sale process for the division. Investors were somewhat puzzled by this development and the share price has since underperformed. With CEO Mullins restructuring the global business with the aim of cross selling the three formerly siloed offerings of Standards, Assurance and Compliance, the announcement that a sale was being considered for one product range was on the surface a mixed message. However, SAI management gave us some comfort on this front. If the division is to be sold, in an ideal world SAI would receive a solid price, would retain the option to still sell assurance services as part of its overall suite of products and would reinvest the proceeds into a software or other service for its higher quality compliance division. With SAI shares offering value in the current market, we will await the outcome of both the sales process and the August full-year profit announcement for further news on the progress at SAI.

Portfolio changes

Key additions and material adjustments

Bought
AGL Ltd (AGL)
Costa Group Holdings (CGC)

There were two new stock additions to the portfolio during 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.

Costa Group Holdings (CGC) – CGC is a horticultural company, one of Australia's leading producers of blueberries, raspberries, citrus and mushrooms. The key attraction from our vantage is CGC's exposure to key 'premium' food categories, with the 'berries' segment currently experiencing very strong growth in consumer demand. CGC is assisting here by expanding capacity, specifically growing product in new locations across the country to ensure it is able to constantly supply product to consumers year round, as distinct from such fruits being 'just' seasonal. By increasing availability to consumers, the shelf price becomes more stable, consumers therefore consume product as part of their daily diet and demand increases accordingly. This trend is increasing and appears sustainable based on global precedent.

CGC has expended significant capital on its production capability. Much of its production relies on irrigation and is either undercover or indoors and so the outright risk of seasonal impacts such as wind, rain and drought is minimised. Further, CGC has built considerable intellectual property and know-how in both the genetics of various fruits but also soil content (substrate) and growing techniques. From our vantage, they appear a leader in their fields. We draw some parallels to our recent successful investments in Bega Cheese (BGA) and Tassal Group (TGR). For each company, the growth outlook is strong, the premium food theme is present and the capital has largely been invested.

Key disposals and material adjustments

Sold
Ardent Leisure (AAD)
Aurizon Holdings (AZJ)

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.

Aurizon Holdings (AZJ) – we elected to take profits in AZJ as the stock reached our assessed fair value. We still like the fundamentals of the business as despite the difficulty facing global coal markets, we believe AZJ is well placed to deliver reasonably steady profits and continue to pay a healthy dividend. AZJ's growth projects are however somewhat capped and this has been reflected in recent write-downs for various expansion projects that were being worked on, but now appear unlikely to proceed. AZJ is speculated to be looking to acquire Glencore's rail assets in the Hunter Valley. Given AZJ already has a presence in the Hunter, such a move is logical, although subject to the price and the AZJ board's appetite for risk, may involve a capital raising. We would re-visit the position in the event of a pull-back in the share price.

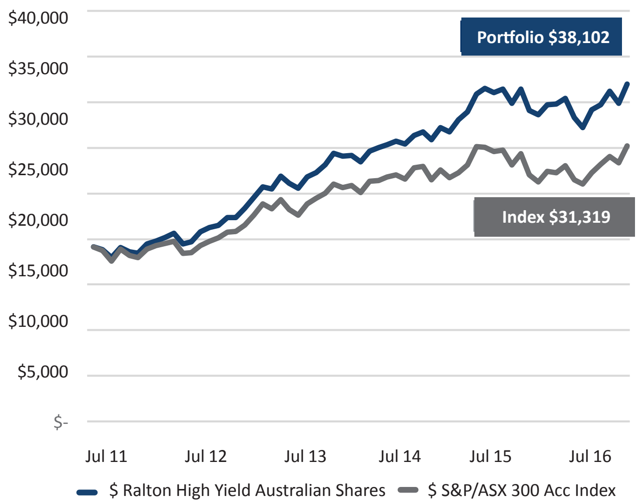
Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Discretionary	11.4%	5.4%	6.0%
Consumer Staples	12.6%	6.9%	5.7%
Utilities	5.9%	2.7%	3.2%
Financials (ex-Property)	36.5%	35.3%	1.2%
Information Technology	2.3%	1.2%	1.1%
Telecommunication Services	5.8%	5.5%	0.4%
Energy	4.0%	3.9%	0.1%
Materials	12.2%	14.3%	-2.1%
Industrials	6.0%	8.1%	-2.2%
Health Care	3.3%	7.3%	-4.0%
Property	0.0%	9.5%	-9.5%
Total	**100.0%**	**100.0%**	**0.0%**

Top 10 holdings#

Company name	ASX code
Westpac Banking Corporation	WBC
Aristocrat Leisure Limited	ALL
Commonwealth Bank of Australia	CBA
Telstra Corporation	TLS
National Australia Bank Limited	NAB
ANZ Banking Group Limited	ANZ
Woolworths Limited	WOW
Macquarie Atlas Roads Group	MQA
QBE Insurance Group Limited	QBE
AMP Limited	AMP

Performance comparison of $20,000*



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Performance of the Ralton Wholesale High Yield 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.