RALTON
ASSET MANAGEMENT

Ralton Smaller Companies
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 Smaller Companies	6.82	11.25	16.36	15.62	15.39	14.07	15.00	8.35
Income return	*0.14*	*0.37*	*1.55*	*3.27*	*3.26*	*3.55*	*3.60*	*3.70*
Growth return	*6.68*	*10.88*	*14.81*	*12.35*	*12.13*	*10.52*	*11.39*	*4.65*
S&P/ASX Small Ord Accum. Index	8.57	11.52	22.34	22.29	8.72	2.38	4.43	-0.06
Difference	**-1.75**	**-0.27**	**-5.98**	**-6.68**	**6.67**	**11.69**	**10.57**	**8.41**

Performance review

- The S&P/ASX Small Ordinaries Accumulation Index posted a strong 8.57% return for the month of July, with strong gains recorded by Materials and Financials, the key contributor to index returns.
- The Ralton Smaller Companies portfolio gained a healthy 6.82% for the month, although underperformed the benchmark by 1.75% for the period.
- Our cash holding, together with our overweight to Industrials, detracted from relative returns, although our overweight position in Consumer Discretionary and Healthcare added to portfolio returns.

Performance attribution

Key contributors

Key contributors	Positioning
Aristocrat Leisure Limited (ALL)	Overweight
IOOF Holdings (IFL)	Overweight
Australian Pharmaceutical Ind. (API)	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.

IOOF Holdings (IFL, +15.5%) – listed wealth manager IFL rose strongly during the month having benefited from a rising market and a positive quarterly update on FUM flows. IFL seeks to generate organic growth from its integrated wealth management business and has been a very successful consolidator in the wealth management space, where its integration skills tend to mean it retains the core value of its acquired businesses while stamping out unnecessary costs. IFL was recently unsuccessful in its attempt to acquire NSW-focused State Super Financial Services (SSFS). Going forward, we fully expect IFL to continue to acquire and add scale to its platform and investment services segments.

Australian Pharmaceutical Industries (API) – shares in API were a top contributor to the portfolio after being added during the month. API has two key business divisions, namely Pharmacy Distribution and Retailing (or 'Priceline'). The Priceline chain of retail stores and pharmacies is the key driver of profit growth and expectations for the ongoing growth in this segment are a key part of our investment thesis. Priceline has some 440 stores with a little over a third being corporate stores and the majority, pharmacist owned and managed franchise operations. In short, pharmacists are responsible for medical dispensary and API manages the retail footprint of the store. The proposition to pharmacists and customers alike is attractive, with API offering a mid or mass-market retail service specialising in health and beauty. API management describes Priceline as "Bunnings for chicks." Features include a strong brand, a highly rated 'frequent flyer' or loyalty program and competitive pricing and offers. Average basket size is $28, suggesting that economic sensitivity is low. Store sales growth has been strong and the model relies on adding circa 20 new pharmacies to the network each year. API has an attractive valuation, solid cash flows, pays what we expect to be a growing dividend yield and will be essentially debt free in the next one to two years.

Key detractors

Key detractors	Positioning
ALE Property Group (LEP)	Overweight
SAI Global (SAI)	Overweight
Sky Network Television (SKT)	Overweight

ALE Property Group (LEP, -4.40) – shares in hotel property investment company LEP were weaker in July and hence underperformed in a strong market. However, rolling year the shares returned a little over 17% to investors including dividends. ALE via its property fund is essentially the landlord for some of Woolworths' pubs and bottle shops. It has a very attractive lease structure with Woolworths. Essentially, value add to the property is funded by the lessee (Woolworths) which drives higher rents (including through two substantial contractual lease resets in 2018 and 2028). Given urban sprawl along the east coast of Australia, ALE has the benefit that many of its sites have considerable space available for future development. We expect future rental growth will be strong, particularly when the major resets take place.

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.

Sky Network Television (SKT, +1.5%) – shares in SKT advanced in the month of July, but given the strength of the market, underperformed on a relative basis. As discussed in our last update, SKT recently announced its intended merger with Vodafone NZ – the local arm of the global telco major. This is an obvious transaction from our vantage as it allows the combined entity to offer its customers a triple play, namely pay TV, mobile and terrestrial telephony services. Globally, pay TV companies such as SKY in the UK, have demonstrated the benefits of offering the triple play and hence why the transaction makes sense. Further, we note Vodafone in the Netherlands is pursuing a similar strategy with the domestic pay TV operator, with the terms of the merger appearing reasonable from an SKT shareholder perspective. However, the deal will have to pass muster with the NZ competition regulator, the NZCC. Assuming this occurs, we see value in the merged SKT entity given the discount at which the stock trades relative to global peers.

Portfolio changes

Key additions and material adjustments

Bought
Australian Pharmaceutical Industries (API)

API was the only new stock added to the portfolio in July and has already been discussed.

Key disposals and material adjustments

Sold
Ardent Leisure (AAD)

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.

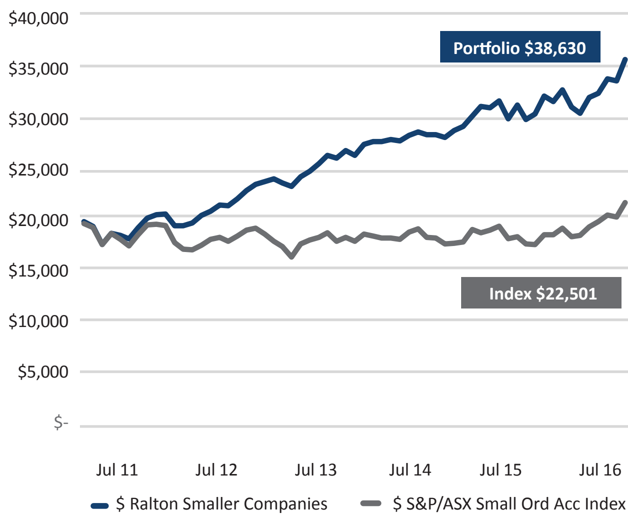
Sector allocation

GICS sector	Ralton	Index	+/-
Financials (ex-Property)	15.2%	7.3%	7.8%
Consumer Staples	12.9%	6.6%	6.3%
Industrials	14.2%	11.2%	3.0%
Health Care	9.3%	7.4%	1.9%
Telecommunication Services	2.3%	1.3%	0.9%
Energy	3.6%	3.7%	-0.1%
Utilities	0.0%	0.9%	-0.9%
Consumer Discretionary	19.8%	21.9%	-2.0%
Materials	17.8%	20.4%	-2.6%
Information Technology	2.4%	7.3%	-5.0%
Property	2.6%	11.9%	-9.4%
Total	**100.0%**	**100.0%**	

Top 10 holdings[#]

Company name	ASX code
Macquarie Atlas Roads Group	MQA
Fisher & Paykel Healthcare Corporation Limited	FPH
Aristocrat Leisure Limited	ALL
Sky Network Television Ltd	SKT
Fletcher Building Limited (Australia)	FBU
Tassal Group Limited	TGR
News Corporation	NWS
Cleanaway Waste Management Ltd	CWY
SAI Global Limited	SAI
Equity Trustees Ltd	EQT

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 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.

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