RALTON
ASSET MANAGEMENT

Ralton Australian Shares
PERFORMANCE REPORT
Quarter to 31 December 2015

Total returns

At 31 December 2015	1 month %	3 months %	6 months %	1 year %	3 years p.a. %	5 years p.a. %	Inception p.a. (Feb 2008) %
Ralton Australian Shares	1.53	5.61	2.93	8.20	14.81	10.49	7.11
Income return	*0.09*	*0.72*	*2.00*	*3.84*	*3.83*	*4.23*	*4.37*
Growth return	*1.44*	*4.89*	*0.93*	*4.36*	*10.98*	*6.27*	*2.74*
S&P/ASX 300 Accum. Index	2.73	6.54	-0.35	2.80	9.01	6.67	3.65
Difference	**-1.20**	**-0.93**	**3.28**	**5.40**	**5.79**	**3.82**	**3.46**

Performance review

- The S&P/ASX 300 Accumulation Index finished the December quarter strongly, adding 6.54%, with Consumer Discretionary and Healthcare sectors the top performing, offset at an index level by weakness in the Materials sector, largely resource stocks.
- The Ralton Australian Shares portfolio added 5.61% for the quarter, underperforming the benchmark by 1.24%.
- For the quarter, being underweight Financials, together with slightly overweight the Energy stocks detracted from portfolio returns. This was offset somewhat by our overweight to Healthcare.

Performance attribution

Key contributors

Key contributors	Positioning
Aristocrat Leisure	Overweight
Super Retail Group Ltd	Overweight
CSL Limited	Overweight

Aristocrat Leisure (ALL, +19.6%) - continued its recent strong run and was a positive contributor to portfolio performance for the quarter. As we discussed in a recent report, the company is now well advanced on its five-year turnaround plan under CEO, Jamie Odell. As part of this turnaround, ALL has invested heavily in product content across its various business divisions. As a direct result of this investment, ALL appears to be gaining market share in the key machine category in the US and Australia, growing its social or 'app-based' games at a healthy rate and finally, the acquisition of VGT last year appears to have been integrated seamlessly into the ALL fold. These factors were all evident in the FY15 profit results in November, where ALL delivered a 79% boost in profits versus the prior year, solid cash flow result and a positive outlook statement.

Super Retail Group Ltd (SUL, +28.1%) - added value to the portfolio, buoyed by a trading update at the AGM in late October. SUL reported solid sales growth in each of its retail formats: automotive, leisure and sports, together with progress on various internal initiatives such as the restructuring of the 'Ray's' format. SUL's internal or 'self-help' initiatives are a key element in our investment thesis, and hence it's pleasing to note the progress also being made on various supply chain, IT and warehouse initiatives SUL has been investing in over the last couple of years. These will make the business more efficient, release inventory (and cash in the process) and allow scope for future growth.

CSL Limited (CSL, +18.1%) - shares in blood plasma producer, CSL, were the top contributor to performance for the period. Now a $48bn company, CSL has grown strongly over many years, benefiting from ongoing demand growth for its mainstay plasma products. At the same time, CSL has invested heavily in research and development (R&D), for both its mainstay blood plasma products, but also 'specialty' products for niche diseases, flu vaccines and more recently cancer treatments – the latter mainly with larger drug company partners. The next two years will, however, bring what CSL is hoping is a step change in new product launches with CSL aiming to release two new 'recombinant' or bacterially grown products for treatment of haemophilia and related conditions. These 'new' products aim to reduce treatment frequency by increasing drug life in the body and also lowering the complication or reaction rate from continued dosing these patients typically suffer from. Our positive view on these new products has been a key reason behind our large holding in CSL.

Key detractors

Key detractors	Positioning
Origin Energy	Overweight
iSelect Limited	Overweight
QBE Insurance Group	Overweight

Origin Energy (ORG, -11.9%) - continued weakness in the oil price weighed on the oil sector with ORG, in turn, weighing on portfolio performance. It has been a torrid year and a half for the energy sector globally with oversupply, geopolitical concerns and modest demand growth contributing to oil price weakness. The oil price has fallen from a peak of US$115 in 2014 to end 2015 in the mid US$30's. Our somewhat contrarian view at this

stage is that oil prices will improve over the next couple of years as annual production declines occur across the whole oil industry, together with the US$250bn or more of future projects and associated capital works that have been cancelled in recent times, lead to a reduction in global supply. Although the outlook in the short term remains unclear, on the basis of our medium-term view we have been cautiously buying stocks such as ORG into the weakness. That said, we remain cognisant of the very strained Middle East geopolitical outlook which could prompt more short-term oil pain.

iSelect Limited (ISU, -24.9%) - shares in ISU remained under pressure, with investors concerned about recent management turnover. Although an indicative, non-binding bid from Providence Equity Partners (a US private equity firm) remained on the table during the quarter, investors were clearly discounting the probability of a formal bid materialising that would, in turn, be acceptable to investors and the board. This discount was somewhat justified in December when ISU confirmed the bid would not proceed. Providence apparently remains interested, however, were unwilling to commit to a bid price ahead of further due diligence and as such, the board closed the process. Our recent meeting with management highlighted the broad opportunities ISU is pursuing across energy, car insurance, telecommunications, life insurance and mortgages. Should ISU be able to gain a small market share in any of these segments, the upside to ISU profits and share price should be attractive. Although ISU has had a series of management changes since listing, we continue to believe the fundamentals of the business and the medium-term opportunity remain sound. Finally, and on a positive note, ISU has also announced details of up to $50m in capital management initiatives, commencing with a 10% share buyback in December.

QBE Insurance Group (QBE, -2.3%) - was weaker during the quarter and detracted from returns. The weakness was driven by commentary at the AGM, with QBE flagging softer premium growth in some of its business lines and insurance margin pressure. Irrespective of the market weaknesses highlighted, we have been impressed by cost efficiencies delivered by QBE in recent years and expect there is more to come. Further, QBE has also made major strides in improving the quality of its capital position and reducing the risk associated with its insurance book. Looking forward, QBE also has material exposure to rising interest rates which, given the likelihood the US Federal Reserve is about to raise short-term rates for the first time in 10 years, and assuming some flow through to longer-dated interest rates – to an extent this has already started – QBE is well placed. Finally, after many years of shrinking the business and focusing internally, QBE management is able to target growth across its businesses by acquiring specialist underwriting teams, something that would be well received by investors.

Portfolio additions and disposals

Key additions and material adjustments

Bought
AMP Limited (AMP)
Independence Group (IGO)
IOOF Holdings Limited (IFL)
G8 Education Limited (GEM)

AMP Limited (AMP) - weakness in AMP gave us an opportunity to add this stock back into the portfolio. Under CEO, Craig Mellor, AMP has continued its multi-year transformation and business simplification. This simplification and efficiency drive has seen AMP continue to rationalise costs, absorb some of the fee pressure from the legislated ‘MySuper’ offering across some of its legacy business and also conduct a significant restructure of its life insurance offering (this division had been a source of concern with higher lapse rates and rising claims). AMP is currently benefiting from reasonably good fund flows into the industry as a whole, as well as new product initiatives, such as FUM flows into AMP’s China platform (part of AMP Capital). At its current share price, AMP offers reasonable value and a solid, likely growing dividend yield.

Independence Group (IGO) - we also added a position in base metals mining company, IGO, to the portfolio. IGO recently merged with Sirius Resources (SIR) (a nickel-focused mining company) whose key asset is the ‘Nova-Bollinger’ nickel discovery in WA. We have a positive view on SIR itself and believe the acquisition will prove to be transformational for IGO. Nova-Bollinger is a first-class nickel asset and production costs are expected to be in the bottom quartile of global producers, an estimate reiterated in IGO’s recent review (project optimisation) of the Nova asset. The mine and associated processing plant are currently under construction with first offtake expected in 2016. In the meantime, weakness in base metal prices, in particular gold, is weighing on the IGO share price. In the medium term, we expect IGO to target becoming a mid-tier mining house with potential for further acquisitions as IGO begins to generate solid cash flows and prove to the market its skills in acquiring larger assets.

IOOF Holdings Limited (IFL) - we further increased our position in financial stocks, adding IOOF to the portfolio. IFL generates organic growth through its exposure to the flow of investor funds into the various phases of the investment cycle where it now has extensive representation. Further, IFL has also been very successful as a major 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. Like other financial service companies, IFL has faced external criticism over internal processes at the organisation. We do not dismiss such issues lightly and, while disappointing, we take comfort from the statements made by management and the board and highlight their favourable track record over many years (i.e. the matters raised appear isolated and not systematic).

G8 Education Limited (GEM) - we added a small position in GEM, an owner and operator of childcare centres in Australia and Singapore. Share price weakness in 2015 has been driven in part by regulatory concerns - more specifically, potential for significant changes in government funding following from a Productivity Commission (PC) review ahead of the Federal Budget. The market was also concerned GEM was paying too high a price to acquire childcare centres and questioned GEM's ability to fund these acquisitions through share issues while simultaneously maintaining its high dividend payout ratio. With the significant decline in the share price, comfort the business operations were on track and finally, having digested the PC draft and final report, we felt the share price weakness was overdone and began to build a position in the stock. We also note GEM has appointed a highly credentialed Chairperson in Mark Johnson, together with the appointment of top-tier audit firm, Ernst & Young.

Key disposals and material adjustments

Sold
Asciano Limited (AIO)
BlueScope Steel (BSL)
Orora Holdings (ORA)
ResMed Inc (RMD)

ResMed Inc (RMD) - we had initially added RMD to the portfolio at a time when investors were focused on the impacts of pricing cuts in the US. Since then, and as expected, these pricing concerns have abated somewhat. RMD has also successfully launched its latest hardware device for sleep disorder breathing, the S-10, in the last year. The launch and sales growth have been exceptional with new features well received by the market. With RMD's competitors now likely to respond with a similar machine and RMD's share price having re-rated, we took the opportunity to take profits in this name. We do have some concerns as to the improvements made by competitors in the 'mask' segment of sleep apnea treatments, although at this stage it looks like RMD market share is proving fairly sticky.

BlueScope Steel (BSL) - added value to the portfolio during the quarter, driven by three key factors. Firstly, BSL and its key stakeholders: employees, their unions and the state government, agreed to a cost-savings program that will see the company target $200m of cost savings and in turn, the Port Kembla steelworks remain open. Secondly, some of these measures have already driven results with BSL able to upgrade its profit expectations for the first-half of the current year. Finally, BSL has opportunistically been able to buy out its joint venture partner in the US-based North Star steel mill. The mill is one of the more efficient plants in the US with very consistent performance including uptime, profitability and customer service. Over time, the business has seen far less cyclicality in end demand, partly due to the metrics just described, but also due to its proximity to key customers – North Star customers are very sticky. Our view is that with 100% ownership, BSL will have more flexibility over the future direction for North Star which, at a group level, improves the overall quality of BSL's assets. The share price re-rate saw us exit our position in BSL.

Asciano Limited (AIO) - as we have discussed in recent reports, Asciano has become subject of a competitive bidding process, with two parties now in the race to acquire the ports and rail operator. The first bidder, Brookfield, is facing regulatory headwinds after Australia's competition regulator, the ACCC, raised 'red light' concerns as to Brookfield's acquisition of AIO. The second bidder, specifically a consortium of investors led by Qube Holdings (QUB) and two large global sovereign funds, have made an indicative, non-binding approach to AIO. From our vantage, it appears Asciano is now highly likely to be acquired – it is just a matter of which of the parties succeed. Various options, including asset splits and even the introduction of new investor partners potentially to circumvent ACCC concerns, is also a possibility. As such, with AIO trading at modest discount to the implied offers and some water to flow under the bridge, we elected to take profits and sell our position.

Orora Holdings (ORA) - lastly, we sold our position in ORA. This is a very well-run company that, since the demerger from Amcor, has executed on its business model in a near faultless manner. With the share price having performed well in recent times, we felt the stock reflected fair value and sold down our position. Given the quality of management, we would look to revisit ORA at a future date should the share price appear attractive, particularly if ORA is able to demonstrate potential to grow its US operations in a profitable manner, either through organic means or acquisitions.

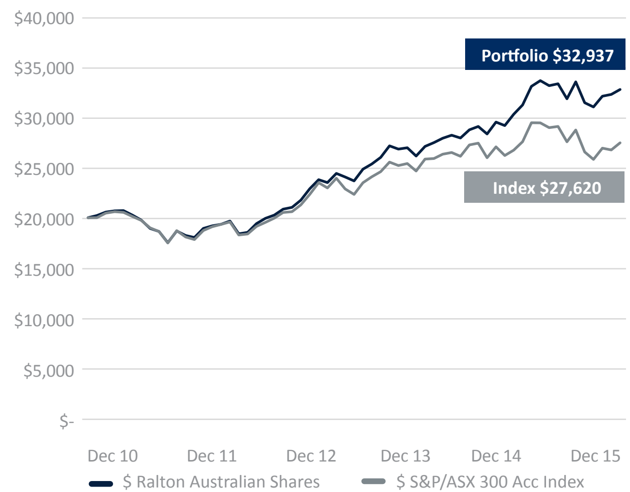
Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Discretionary	16.3%	5.0%	11.3%
Energy	7.4%	4.0%	3.5%
Health Care	9.0%	6.8%	2.2%
Information Technology	3.2%	1.1%	2.1%
Industrials	7.7%	7.9%	-0.2%
Consumer Staples	6.9%	7.2%	-0.2%
Materials	11.0%	12.1%	-1.0%
Utilities	0.0%	2.3%	-2.3%
Financials (ex-Property)	36.7%	39.9%	-3.3%
Telecommunication Services	0.0%	5.4%	-5.4%
Property	1.7%	8.3%	-6.6%
Total	100%	100%	

Top 10 holdings#

Company name	ASX code
National Australia Bank Limited	NAB
Commonwealth Bank of Australia	CBA
Westpac Banking Corporation	WBC
CSL Limited	CSL
QBE Insurance Group Limited	QBE
Aristocrat Leisure Limited	ALL
ANZ Bank Group Limited	ANZ
Incitec Pivot Limited	IPL
Coca-Cola Amatil Limited	CCL
AMP Limited	AMP

Performance comparison of $20,000*



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* The performance comparison of $20,000 over 5 years is for illustrative purposes only. All returns shown are based on Australian dollar figures. Past performance is not a reliable indicator of future performance. The total returns shown are prepared on an exit-to-exit basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the S&P/ASX 300 Accumulation Index is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an 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.

Past performance is not a reliable indicator of future performance.

Performance of the Ralton Australian Shares Managed Account is based on theoretical portfolio tracking of the model portfolio and is gross of investment management and administration fees, but net of transaction costs. The total return performance figures quoted are historical, calculated using end-of-month mid prices and do not allow the effects of income tax or inflation. Total returns assume the reinvestment of all distributions. This document is for general information purposes 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 the appropriateness of the information to their needs. This may involve seeking advice from a qualified financial adviser. Copia Investment Partners Ltd (AFSL 229316, ABN 22 092 872 056) (Copia) is the provider of the Ralton Australian Shares Managed Account model portfolio advisory service. To subscribe to this service please contact Copia by calling 1800 442 129. Any opinions or recommendation contained in this document are subject to change without notice and Copia is under no obligation to update or keep any information contained in this document current.