## Total returns

| At 30 September 2017 | 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 | 4.19 | 6.34 | 4.78 | 11.11 | 13.26 | 14.75 | 12.79 | 8.56 |
| *Income return* | *0.02* | *1.02* | *1.29* | *2.55* | *2.88* | *3.24* | *3.57* | *3.79* |
| *Growth return* | *4.17* | *5.32* | *3.48* | *8.56* | *10.39* | *11.51* | *9.22* | *4.77* |
| S&P/ASX Small Ord Accum. Index | 6.02 | 10.32 | 10.58 | 14.58 | 10.48 | 6.05 | 2.65 | 0.84 |
| **Difference** | **-1.83** | **-3.98** | **-5.80** | **-3.47** | **2.78** | **8.70** | **10.14** | **7.71** |

## Performance review

- The S&P/ASX Small Ordinaries Accumulation Index added 6.02% for October, continuing recent gains with the strong support of Consumer Staples and Materials
- The Ralton Smaller Companies portfolio returned 4.19% for the month, underperforming the benchmark by 1.83%.
- The portfolio's cash holding and underweight positions in Financials and Consumer Staples each weighed on relative investor returns. Specifically for Consumer Staples, not holding A2 Milk (A2M) was a material drag on portfolio returns against the benchmark given the stellar performance of this one stock and its weight within the index.

## Performance attribution

### *Key contributors*

| Key contributors | Positioning |
|---|---|
| Blackmores Limited | Overweight |
| Nextdc Limited | Overweight |
| Beach Petroleum | Overweight |

Vitamins and nutritionals company **Blackmores (BKL, +35.4%)** rallied in October following a well received quarterly trading update. The result for the first quarter marked a turning point following several quarters of declining profits in the wake of the inventory build and related regulatory concerns, principally in the key Chinese market. This was a pleasing result from our perspective given we only revisited BKL around mid-year. The company also confirmed that growth in Chinese sales came largely from direct or 'in country' sales channels, whereas the 'diagou' or tourist shopping channels are no longer powering BKL sales. In the medium-term, China and other Asian markets offer huge potential for consumer companies such as BKL, allowing them to tap into the emerging market growth themes and increased per capita spend as the middle class grows. BKL has a very strong and well credentialed brand and a long-established presence in Asia, which if they continue to successfully execute offers excellent opportunities for investors. The caveat, of course, is the price and valuation of BKL shares which we continue to monitor.

**Nextdc Limited (NXT, +18.4%)** – data centre owner and operator NXT was a strong contributor to portfolio returns in October, and is now up 40.2% rolling year. The business model relies on acquiring and building data centres close to major population centres. NXT then rents out space in these facilities to corporates and governments with significant data and security requirements. NXT is in the early stages of construction and contracting for its 'series 2' data centres on the Eastern seaboard. Despite the intensity of the execution phase for NXT, the company remains an innovator. NXT recently lifted its own targets for construction standards, energy, efficiency and service. Specifically, these next generation data centres will now aim to achieve Tier IV design and construct certification as well as industry leading 'NABERS' 5.0 star energy efficiency design. Medium-term we believe the potential exists for NXT to double or more the size of its currently planned data centres, subject to demand, execution and the market remaining rational. This potential is supported by the thematic tailwind of the move to cloud computing.

**Beach Petroleum (BPT, +20.1%)** – shares made further gains in October, supported by a solid quarterly production report, stability in the oil price and likely investor comfort with the recent $1.57bn acquisition of Lattice Energy, the upstream oil and gas assets of **Origin Energy (ORG)**. The assets include several key stakes in Australian focused oil and gas fields, including the Waitsia development opportunity in WA. With BPT themselves having succeeded in simplifying and reducing the drilling costs and drill time for its own assets, the opportunity now exists for BPT to leverage the learnings and seek to reduce costs across to the Lattice business. With all its corporate distractions, ORG has likely left some opportunities on the table.

The Lattice gas producing assets typically have medium term offtake agreements with various energy retailers, priced it appears around $6/GJ. In future years, based on current market dynamics, these contracts are likely to reprice higher, providing upside to the assumptions that BPT took on as part of the deal. In the short term, BPT will be focused on using the steady cash flows from Lattice and its other oil and gas assets to reduce the debt levels. We are comfortable with the debt levels, but like most investors, will be keen to see BPT achieve its 2019 gearing targets as early as possible.

***Key detractors***

| Key detractors | Positioning |
|---|---|
| Fletcher Building | Overweight |
| Ainsworth Game Tech | Overweight |
| OFX Group | Overweight |

**Fletcher Building (FBU, -12.1%)** – shares fell following a further revision to profit guidance at the Annual Shareholders Meeting in New Zealand. Though one of the portfolio's top performers in 2016, FBU has endured a horror 2017. The catalyst was problematic construction contracts in New Zealand, specifically the International Convention Centre in Auckland where FBU is losing money on the job, making a material dent in future profits. The company's problems have led to a change in CEO and FBU has now announced that Ross Taylor will lead the FBU conglomerate. Taylor was successful in his tenure at United Group where he led a turnaround of predominately a contractor business that had similarly come unstuck by one major oil and gas contract. On a more positive note, FBU's businesses are far more diverse than just contracting, and although this one area has driven a material fall in the share price, we have retained a positive view of FBU's other businesses. We expect the new CEO will be able to build confidence in FBU, although it may take some time.

**Ainsworth Game Technology (AGI, -10.6%)** – shares gave back some of its gains following the recent full year results. As we highlighted in the September quarterly report, industry feedback continues to indicate that AGI's latest game offerings are gaining share in the key US market and that the turnaround at AGI is gaining some traction. Although it was not yet evident in FY17 unit sales, the outlook for orders in both the US and the Australian market is improving, with positive feedback from the gaming conventions in Australia and the US. We took some profits in AGI, although retain a solid holding and continue to monitor the pace of the turnaround.

**OFX Group (OFX, -19.8%)** – this recent portfolio addition was weaker in October, although there was no company specific news flow. We see a turnaround opportunity in OFX given the attractive market and the new leadership team. OFX's core business is online foreign currency transfers, targeting quality service at a far lower cost to the banks, who still dominate this segment of banking, despite their high fees. New CEO Skander Malcolm has impressive credentials in business across several international jurisdictions. His current focus is on simplifying the business and executing well across a small number of initiatives. The balance sheet is in good shape and risk measures and compliance, which are key for this type of business, appear sound. At this stage, we have taken a small position in OFX, but wait to increase the size of our exposure as we gain confidence around Skander, his team and the new strategy. Skander's first annual profit results in November will provide a guide as to how we see the progress being made on the OFX turnaround.

## Portfolio changes

***Key additions and material adjustments***

| Bought |
|---|
| Healthscope Limited (HSO) |

**Healthscope Limited (HSO)** – we added Australia's number two hospital operator to the portfolio in October. The stock was relisted via IPO in mid-2014. The share price rallied circa 50% at its peak before recently reverting toward the IPO price, and now below, where we view the valuation as interesting. Recent concerns included the exit of longstanding CEO Rob Cooke and a slow-down in hospital admissions during calendar year 2016 which coincided with HSO bringing more bed capacity onto the market. Newly opened greenfield hospitals have also taken slightly longer than expected to reach budget targets.

Broader private health insurance (PHI) affordability concerns have also weighed on the stock. This will likely cap PHI participation in years to come, although we expect that the core of HSO's patients, the 50-plus age demographic, will attempt to maintain PHI to secure access to their preferred hospitals and surgeons. Recent reform measures outlined by the Federal Government appear supportive of PHI. On this basis, and assuming HSO can grow admissions by around 2-3% per annum, we believe HSO offers reasonable value over the medium-term.

***Key disposals and material adjustments***

| Sold |
|---|
| Nil |

There were no outright sales for the month, though we did take profits in some portfolio names, including some portfolio names including **Beach Petroleum (BPT)**, **Macquarie Atlas Roads (MQA)** and **Fisher and Paykel Healthcare (FPH)**.

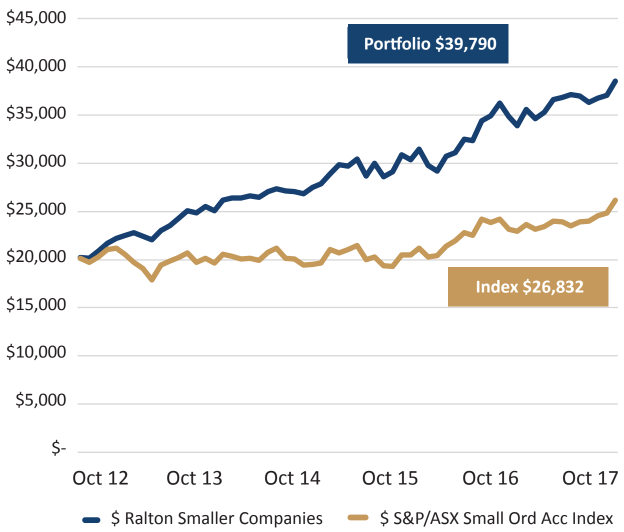
## Sector allocation

| GICS sector | Ralton | Index | +/- |
|---|---|---|---|
| Health Care | 16.9% | 6.5% | 10.4% |
| Telecommunication Services | 5.4% | 1.8% | 3.6% |
| Utilities | 2.5% | 0.6% | 1.9% |
| Financials | 9.3% | 8.0% | 1.2% |
| Energy | 6.9% | 6.6% | 0.3% |
| Consumer Staples | 11.7% | 11.5% | 0.2% |
| Information Technology | 6.4% | 7.1% | -0.7% |
| Materials | 16.6% | 17.5% | -0.9% |
| Industrials | 7.3% | 9.4% | -2.1% |
| Real Estate | 7.6% | 11.9% | -4.3% |
| Consumer Discretionary | 9.4% | 19.1% | -9.7% |
| **Total** | **100.0%** | **100.0%** | **0.0%** |

## Top 10 holdings#

| Company name | ASX code |
|---|---|
| Worleyparsons Limited | WOR |
| Nextdc Ltd | NXT |
| Fisher & Paykel Healthcare Corp Ltd | FPH |
| Tassal Group Limited | TGR |
| Japara Healthcare Lt | JHC |
| Blackmores Limited | BKL |
| Nufarm Limited | NUF |
| Speedcast Int Ltd | SDA |
| Pact Group Holdings Ltd | PGH |
| Macquarie Atlas Roads Limited | MQA |

## 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 Small Ordinaries 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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