Total returns

At 31 December 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 Leaders	1.97	6.68	6.44	12.28	8.85	12.25	10.05	7.30
Income return	*0.16*	*0.77*	*2.20*	*4.21*	*3.97*	*4.03*	*4.30*	*4.51*
Growth return	*1.81*	*5.91*	*4.24*	*8.07*	*4.88*	*8.23*	*5.76*	*2.79*
S&P/ASX 100 Accum. Index	1.71	7.07	7.52	11.04	8.21	10.32	8.62	5.61
Difference	**0.27**	**-0.39**	**-1.08**	**1.24**	**0.64**	**1.93**	**1.44**	**1.68**

Performance review

- The S&P/ASX 100 Accumulation Index was strong in the quarter, adding 7.07% for the period, boosted by strong gains for Energy and Information Technology.
- The Ralton Leaders portfolio added 6.68% in the quarter, underperforming the benchmark by 0.39%.
- For the December quarter our overweight exposure to Consumer Discretionary and stock selection within Industrials and Health Care each added value to the portfolio. Offsetting these gains was negative stock selection within Real Estate, our underweight exposure to Materials and further, our modest cash exposure in a rising market.

Performance attribution

Key contributors

Key contributors	Positioning
Healthscope	Overweight
Aristocrat Leisure	Overweight
Santos Limited	Overweight

Healthscope Limited (HSO, +25.8%) – shares in Australia's second largest hospital group rebounded strongly in the December quarter. Confirmation of new CEO Ballantyne's profit guidance for the current financial year was likely the trigger, as investors begin to understand the progress being made by the new CEO and the expectation of no further profit shocks. Newly opened greenfield hospitals have also taken slightly longer than expected to reach budget targets. The benefit of a new CEO is that they are able to reset expectations and then leave scope to beat their own rebased numbers!

Recent reform measures outlined by the Federal Government in relation to private health insurance (PHI) appear to be well thought through. The expectation of a simplified system with incentives for younger people to take out insurance, and some improvement in affordability from cost savings in medical prosthesis should prove supportive for both PHI participation and service providers alike. Our expectation remains that HSO can grow admissions around 2-3% per annum, and on this basis we see HSO as reasonable value over the medium term.

Aristocrat Leisure (ALL, +12.9%) – ALL shares added value to the portfolio following a solid half year result and the acquisition of BigFish Social Gaming. Both announcements were made on the last day of November. The negative share price fall was a touch surprising as we highlighted during our November report, however by the end of quarter the shares had subsequently rebounded. Turning briefly, to the half year profit result, the numbers from our vantage were good quality and in line with expectations. Strong performance by ALL's Americas region, Gaming Ops, Digital and Class 3 outright sales segments contributed to some 36% growth in profit for the period. The market was maybe surprised by the softer tone around management's FY18 guidance – management have traditionally been conservative.

The main focus however was the acquisition of the BigFish Social Gaming Firm. This may also have had an impact on the share price. At an acquisition price of US$990m, this represents a material transaction for ALL. Once the deal completes ALL will become the No 2 player in social gaming globally, with ''digital'' revenue at ALL accounting for near 40% of revenue. Our initial view is that the transaction makes strategic sense and builds upon ALL's exposure to the broader digital segment, which itself targets a younger demographic than ALL's traditional end customers. The initial share price move (which as we write has somewhat recovered) is likely ''sticker shock" as investors digest the size of the acquisition. Given ALL's track record in terms of integrating large acquisitions, adding growth to the businesses they acquire and rapidly reducing debt, we have confidence, that in time the acquisition can add value for shareholders.

Santos Limited (STO, +35.6%) – STO's shares rose across the quarter, boosted by a rising oil price, further progress on STO's operational turnaround and finally, speculation of M&A from a US private equity backed group called Harbour.

STO's investor day in November provided further confirmation that CEO Gallagher's operational turnaround and strategic reset of the business continues to deliver. Gallagher and his team have delivered impressive results in terms of cost reduction and more efficient drilling processes. Together with a reset of the balance sheet, lower interest costs and focus on core assets, these factors have combined to lower the cash flow breakeven of STO's various assets. At current oil prices, this drives solid free cash flow and further debt reduction and perhaps more importantly, provides a good buffer in terms of cash flows, should oil prices retest recent lows.

STO's share price was boosted further in mid November by media coverage suggesting that a group called 'Harbour,' backed by various private equity interests was expected to make a takeover offer for STO. The press speculation remains just that, however, Harbour has certainly approached the STO board in recent times with a non-binding proposal. The Harbour interest in STO somewhat confirms our own investment thesis, although we hold no particular insights as to whether further corporate activity is likely.

Key detractors

Key detractors	Positioning
Lendlease Group	Overweight
IOOF Holdings	Overweight
National Australia Bank	Overweight

Lend Lease (LLC, -8.8%) – LLC gave back prior share price gains following a market update in mid October. Although LLC's update broadly maintained profit expectations for the current year, the composition of earnings and issues within the Australian construction business were not well received by the market. Specifically, this division is now likely to deliver lower EBITDA than the prior year due to losses on some small, but problematic contracts. Our logic in revisiting LLC during May was focused on increasing the portfolio's exposure to the Australian east coast infrastructure theme. Lend Lease recently restructured its infrastructure team and aims to deliver $4-5bn in annual revenues from this division. This would nearly double current revenues, with LLC seeking a commensurate improvement in margins. Although these problematic contracts represent a step backwards for this division, these contracts were written and won several years ago, and hence we do not view them as representative of management and contract risk structures since put in place.

IOOF Holdings (IFL, -3.9%) – IFL shares traded lower in the December quarter against the back drop of a rising market. The major news for IFL during the quarter was the proposed acquisition of part of ANZ's wealth division. In a near $1bn transaction, IFL has agreed to acquire ANZ's pensions and investment business, increasing debt and raising new equity to fund the transaction. Although initially well received by investors (including ourselves) the transaction will take some time to be approved and completed, which may weigh on investor sentiment.

IFL has also been very successful as a major consolidator in the wealth management space, where its integration skills allow it to retain the core value of its acquired businesses while stamping out unnecessary costs. Having consolidated multiple platforms, IFL is now targeting an improved service offering to financial advisers and clients. IOOF is particularly focused on the flexibility, or 'open architecture', of its investment platforms which allows advisers to personalise investment services, rather than being restricted to in-house product offers. We like IOOF's focus on the customer which differentiates it from the big banks and other large financial institutions, particularly at a time when community trust in the banks is increasingly questioned.

National Australia Bank (NAB, -6.1%) – At NAB's full year results in November investors took a cautious view of CEO Thorburn's latest corporate restructure, marking the stock down some 6% for the quarter (~3% ex dividend). Specifically, an increased investment spending program over the next three years will see a material step-up in costs next financial year, driving lower profit growth. These one-off costs are of course targeting future returns through IT investment, automation and digitization of processes. The end game is an improvement in efficiencies, a material reduction in staff and an aggressive cost-to-income (CTI) target in the outer years. Achieving these medium term targets would be a strong positive for NAB and likely position the bank well in a competitive sense, subject of course to how its peers respond. The actual profit results for FY17 were reasonably clean from our vantage, setting aside the typical small variations that punctuate any company's results.

Portfolio changes

Key additions and material adjustments

Bought
Coca-Cola Amatil (CCL)
Macquarie Group (MQG)

Coca-Cola Amatil (CCL) – share price weakness and a less negative view in respect to the impact of the container deposit scheme (CDS) led us to revisit CCL. Although pressure remains on the group's core CSD or carbonated soft drinks division, we expect that new product launches across a range of beverage options, together with further cost efficiencies, can see CCL deliver modest growth in profits. CCL's CSD headwinds are well known and indeed a global phenomenon, which means that the parent company (KO) is working overtime on new products to sell through its pipes. CCL in Australia and Indonesia is the beneficiary of these efforts.

The pending CDS would see a levy charged on drinks containers at the point of purchase to cover part of the recovery and scheme costs. Early indications are that the retailers will be passing this cost on to the consumer in full. We will be monitoring both pricing to the consumer and potential volume impacts to determine to what extent CCL is impacted in the short term.

Early expectations suggest that costs are being passed on to the consumer rather than the producer being forced to bear the extra cost. Should this be maintained and given many market analysts appear to expect that CCL will bear the cost, such an outcome could certainly be well received by a skeptical investment community.

We added a position in **Macquarie Group (MQG)** during the month. MQG under CEO Moore has materially reshaped the business over several years. The transformation of the MQG business to a higher 'annuity' share has changed the risk profile from its days as a more pure play investment bank. The annuity style businesses are heavily focused on funds management, with a range of asset classes managed by Shemara Wikramanayakeim, Head of Macquarie Asset Management. The cost-to-income ratio (CTI) is still transforming to reflect the change in profile of the business with a substantial reduction in CTI possible overtime. This provides a substantial amount of scope to drive/maintain earnings. MQG offers a good yield versus that of the broader market.

Key disposals and material adjustments

We exited four investments outright during the period.

Sold
Macquarie Atlas Roads (MQA)
Origin Energy (ORG)
Treasury Wine Estates (TWE)
QBE Insurance Group (QBE)

Macquarie Atlas Roads (MQA) – We elected to sell our long held position in MQA during the quarter. MQA shares had rallied to an all-time high, following the recent capital raise to the support the purchase of an additional 4.9% in the APRR toll road network. News that long time CEO, Peter Trent, was set to resign in February 2018, replaced by James, Hooke, current CEO of Macquarie Infrastructure Corporation was also well received by the market. Trent has been integral to the restructure, simplification and now expansion of MQA in the last eight years. With the commensurate reduction in yield for MQA securities and the stock trading at what we felt was fair value we took the opportunity exit our holding in MQA.

With shares in **Origin Energy (ORG)** at $8, which we view as fair value, we elected to sell our holding. Since its lows and the capital raising of late 2015, the stock has been a strong contributor to the portfolio. New CEO Calabria has continued to reduce debt, simplify the business and successfully bring the two Gladstone LNG trains online without a hiccup. Unless oil and LNG prices push higher from current levels we see limited upside for ORG, although will continue to monitor this stock.

Treasury Wine Estates (TWE) – Michael Clarke led TWE has continued to reward investors this year. The new brand-led TWE has optimized its supply chain, improved the quality of its mix of wines and is now far more accomplished at directing its higher quality wines to optimal regions and channels across the world. This has driven an improvement in margins and reduced the volatility in profits that many would expect from a wine company.

Under Clarke's leadership, sales trends in each region have improved or stabilized, including the 'problem child' US market. A stock of aged wine, kept in store and marked at cost on the balance sheet, provides TWE with a buffer against the vagaries of agricultural production. Going forward, TWE recently raised the bar further, targeting another material uplift in EBIT margins. Although a date has not been set for this achievement, Clarke's track record and continued ability to over deliver on targets saw the shares well supported in recent times. However reflecting both the share price gains, market expectations for ongoing margin expansion and our view of valuation we elected to sell our position in TWE.

QBE Insurance Group (QBE) – we funded our holding in MQG through the outright exit of QBE. A number of QBE's core businesses have underperformed in recent times, testing our faith in what we saw as a long held, turnaround candidate under CEO Neal. Although we believe the stock continues to look cheap, the continuous series of set-backs for the company and now a new CEO, we have elected to remove the position. IOOF and MQG remain our preferred investments in the financial services sector.

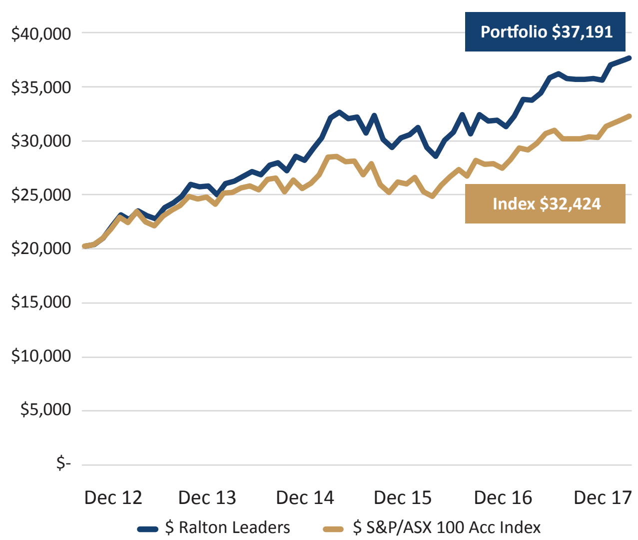
Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Staples	10.8%	7.3%	3.4%
Consumer Discretionary	6.3%	3.3%	3.0%
Information Technology	4.1%	1.3%	2.8%
Health Care	8.3%	7.1%	1.2%
Utilities	2.9%	2.2%	0.7%
Telecommunication Services	3.6%	3.2%	0.4%
Energy	5.1%	4.9%	0.2%
Materials	16.9%	17.6%	-0.7%
Real Estate	6.2%	7.8%	-1.6%
Industrials	4.6%	7.1%	-2.5%
Financials	31.2%	38.2%	-7.0%
Total	**100.0%**	**100.0%**	**0.0%**

Top 10 holdings#

Company name	ASX code
BHP Billiton Limited	BHP
ANZ Banking Group Limited	ANZ
National Australia Bank Limited	NAB
Westpac Banking Corp	WBC
Woolworths Limited	WOW
Aristocrat Leisure Limited	ALL
Commonwealth Bank of Australia	CBA
Boral Limited	BLD
Telstra Corporation	TLS
Wesfarmers Limited	WES

Performance comparison of $20,000*



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*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 100 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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