Ralton High Yield Australian Shares
Portfolio Update | 30 September 2016

Total returns

At 30 September 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 Yield Australian Shares	0.87	6.23	8.46	10.09	9.47	15.28	9.66	7.44
Income return	*0.42*	*1.41*	*2.96*	*5.26*	*4.77*	*5.00*	*4.96*	*5.04*
Growth return	*0.44*	*4.82*	*5.50*	*4.83*	*4.70*	*10.28*	*4.70*	*2.40*
S&P/ASX 300 Accum. Index	0.51	5.24	9.43	13.50	6.03	11.02	6.46	4.09
Difference	**0.35**	**0.99**	**-0.97**	**-3.41**	**3.44**	**4.26**	**3.20**	**3.35**

Performance review

- The S&P/ASX 300 Accumulation Index rose 5.24% for the September quarter with Materials and Consumer Staples the top performing sectors, while both Utilities and Telecommunications recorded a negative return.
- The Ralton High Yield portfolio finished the quarter up 6.23%, outperforming the benchmark by 0.99%.
- For the quarter, being overweight Consumer Staples and being underweight Real Estate added value for investors. This was somewhat offset by stock selection within Financials.

Performance attribution

Key contributors

Key contributors	Positioning
Coca-Cola Amatil (CCL)	Overweight
Aristocratic Leisure (ALL)	Overweight
SAI Global Limited (SAI)	Overweight

Reporting season was the key driver for many of our portfolio holdings in the quarter. Listed companies report their financial progress for the completed period (half or full-year results) in August and provide outlook commentary on the year ahead.

Coca-Cola Amatil (CCL, + 24.5%) – a solid half-year earnings result in August combined with low market expectations, saw CCL's shares rally across the quarter. From our perspective, the half-year result confirmed CEO Alison Watkins' turnaround of the Australian and Indonesian businesses is gaining traction. In particular, we would highlight the positive results from CCL's growth engines - both Indonesia and domestic non-carbonated soft drink (CSD) products. These non-CSD products or "stills" include sparkling mineral water, dairy, juice and alcohol. By volume, stills account for circa one third of CCL's sales, and rising. Each product leverages CCL's impressive infrastructure, such as supply chain, distribution reach and marketing capability. The reason this shift to 'stills' is important is that consumer preferences are shifting. This mix shift coupled with sensible pricing and marketing investment in the core CSD business, should mean CCL can return its business to reliable growth and good cash flows, supporting healthy dividend growth for investors.

Aristocrat Leisure (ALL, +14.6%) – shares in ALL again added value for the portfolio. ALL's game line-up continues to be well received with feedback from the recent 2016 Global Gaming Expo (G2E) highly positive. New titles, including strategic licenses, the continued popularity of "Lightning Link" and even a shift into new product segments, such as "Stepper" and video lottery terminal (VLT), were all well received by the industry. With ALL's product suite continuing to gain market share and the company producing strong free cash flow, we continue to have a positive view.

SAI global (SAI, +27.1%) – shares in SAI rallied strongly, following the proposed acquisition by Baring Private Equity. We had been supportive of the restructuring of SAI under CEO Peter Mullins and believe it was on the cusp of delivering a material increase in sales momentum. Clearly, others felt the same or recognised value in the assets that SAI owns. The trigger for private equity moving toward a purchase of the whole business appears to have been moves by the company to sell or consider the sale of its Assurance division. We also note Baring Private Equity was part of a consortium that recently purchased the Intellectual Property & Science business of Thomson Reuters. To digress, this is an information product that provides services and information to a series of customers, largely scientific bodies, academia, corporations and government. Certainly this type of business sounds synergistic with Standards Australia (SA) and would offer a platform from which SA could distribute its content more broadly. Irrespective, we have sold our position for a modest profit.

Key detractors

Key detractors	Positioning
QBE Insurance Group (QBE)	Overweight
BHP Billiton Limited (BHP)	Underweight
Incitec Pivot Ltd (IPL)	Overweight

QBE Insurance Group (QBE, -10.9%) – a poor result from QBE's Australian division was a key drag on the half-year results and overshadowed reasonable progress being made in other jurisdictions. QBE's CEO, conscious of recent missteps, has taken decisive action changing leadership in Australia. QBE expects remedial action, including pricing discipline, and government reform in workers' compensation insurance will see the Australian issues fixed reasonably quickly. Progress on cost reductions, moderate total premium growth and an improved balance sheet, provide us with confidence on QBE's multi-year progress. The share price fall together with these factors saw us increase the position shortly after the result.

Our underweight exposure to resource stocks and **BHP Billiton (BHP, +20%)** in particular, was a key detractor from portfolio returns. Commodity pricing for oil, iron ore and coking coal, three of BHP's key commodities, have been rising off recent lows. Each commodity has its own nuances, although the rise in price for key steel-making ingredients, iron ore and coal, has been supported by strong credit growth in China this year. We remain skeptical in terms of China's ability to sustain this demand and hence the sustainability of current prices. Although multi-factorial, our expectation for oil is for prices to stabilise as supply is likely to remain rational in the face of weaker prices. We have exposure to this theme via our holdings in Origin Energy (ORG), Santos limited (STO) and BHP.

Chemical and fertiliser company **Incitec Pivot (IPL, -5.1%)** detracted from returns in a rising market. IPL has been a poor performer for the portfolio all year, weighed down by mounting price headwinds in several of IPL's key business exposures, namely fertilizer, both DAP and Urea. Further, IPL's long awaited Louisiana Ammonia plant is set to commission shortly, into a currently depressed price environment for ammonia. That said, we would highlight a couple of supportive factors for IPL. Firstly, market pricing for either IPL's products and several of its end customers (such as coal miners) is inherently linked to the oil price. The reduction in oil and gas price has lowered cost inputs for many industry participants who produce urea, ammonia and DAP and this in turn has lowered benchmark pricing for these products. This will work in reverse of course, and as we have already seen the oil price rise off its lows, we expect this, together with a rational supply response, will flow though to pricing (and profits) for IPL. Second, the pending commission of IPL's new ammonia plant will see a significant shift in free cash flow generation. For these reasons, we recently up weighted our holding in IPL as we believe the share price to be attractive.

Portfolio changes

Key additions and material adjustments

We added three new stocks to the portfolio during the quarter, each of which is discussed below.

Bought
Ainsworth Game Technology Limited (AGI)
AGL Energy Ltd (AGL)
Costa Group Holdings (CGC)

AGL Ltd (AGL) – we added a position in utility company AGL during July. An investment in AGL has three supportive features from our vantage. First, under CEO Vessey, AGL has made considerable progress in driving productivity improvements to boost profits. Second, 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. We note recent speculation, which suggests once more, that various Brown coal electricity generators are likely to close, an outcome from which AGL would benefit. 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. Since our purchase, we note AGL was unsuccessful in acquiring the WA-focused Alinta assets, which instead look set to IPO. AGL has however, committed to a share buyback and increased dividend payout ratio.

Ainsworth Game Technology (AGI) – we added a position in AGI to the portfolio following its full-year results. The gaming machine manufacturer has recently welcomed European domiciled Novomatics to its share register after acquiring founding shareholder Len Ainsworth's 53% equity holding. AGI is aiming to deliver material synergies including cost savings, access to an extensive software library and sales into Europe. Together with a likely bottoming of market share in Australia in coming periods and a strong outlook for market share gains in the US, we have a positive outlook for AGI on a multi-year view. Similar to Aristocrat Leisure (ALL) several years ago, we see AGI as investing appropriately in research and development (new products) at the bottom of its market share cycle as a lead indicator for future revenue growth. This remains subject to execution, which we continue to monitor.

Costa Group Holdings (CGC) - is a horticultural company and 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 the genetics of various fruits, soil content and growing techniques. From our vantage, they appear a leader in their field. 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

There were four outright stock sales from the portfolio during the quarter, with the sale of SAI already highlighted.

Sold
Ardent Leisure (AAD)
Aurizon Holdings (AZJ)
SAI Global Limited (SAI)
Sky Network Television (SKT)

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. Subsequent to our sale, AAD announced the sale of its health clubs or gym division to a private equity group. This transaction was somewhat unexpected and also realised a healthy price tag, and hence shares in AAD rallied strongly.

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 and 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 and may involve a capital raising. We would revisit the position in the event of a pull-back in the share price.

Sky Network Television (SKT) – we were a somewhat forced seller of SKT. The NZ commerce commission or NZCC is set to make a decision on the merger of SKT with Vodafone NZ in the near term. As highlighted previously, we believe this transaction makes absolute strategic sense and offers value to SKT shareholders and indeed prospective shareholders alike if the merger proceeds. Despite this, we believe the NZCC decision is somewhat binary and we were unable to gain sufficient comfort that it will be waved through – decisions by the regulator can be very hard to predict. On this basis, we concluded the risk/reward was poor. If the deal is approved, shares are likely to rise, however the opposite is equally true. Further, if the deal was to be knocked back, this would leave SKT somewhat strategically challenged. As investors, we do not like risk we cannot quarantine, hence our decision to sell. If the decision is approved, we would look to revisit our holding in SKT, subject of course to price which, as highlighted, is likely to move higher.

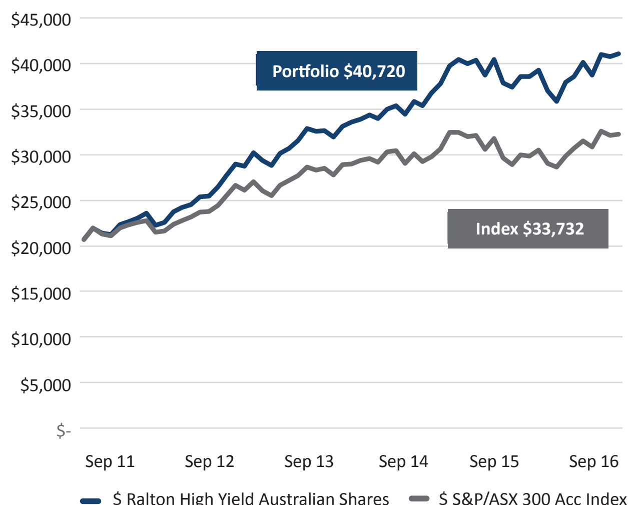
Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Staples	14.3%	7.2%	7.1%
Consumer Discretionary	10.2%	5.5%	4.7%
Utilities	6.2%	2.5%	3.8%
Financials (ex-Property)	37.2%	35.4%	1.8%
Information Technology	2.8%	1.5%	1.3%
Telecommunication Services	6.1%	4.9%	1.1%
Energy	4.4%	4.0%	0.3%
Materials	14.7%	15.6%	-0.9%
Industrials	2.5%	7.3%	-4.8%
Health Care	1.7%	7.1%	-5.4%
Property	0.0%	9.1%	-9.1%
Total	**100.0%**	**100.0%**	**0.0%**

Top 10 holdings#

Company name	ASX code
Westpac Banking Corporation	WBC
Telstra Corporation	TLS
Commonwealth Bank of Australia	CBA
Aristocrat Leisure Limited	ALL
Woolworths Limited	WOW
National Australia Bank Limited	NAB
ANZ Banking Group Limited	ANZ
QBE Insurance Group Limited	QBE
Coca-cola Amatil Limited	CCL
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.

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