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 Smaller Companies	4.02	12.94	19.16	26.17	15.27	18.66	13.24	8.87
Income return	*0.65*	*0.98*	*1.25*	*2.89*	*3.08*	*3.54*	*3.57*	*3.73*
Growth return	*3.37*	*11.96*	*17.91*	*23.28*	*12.19*	*15.12*	*9.67*	*5.15*
S&P/ASX Small Ord Accum. Index	1.53	8.50	14.84	29.16	7.07	5.27	2.78	-0.07
Difference	**2.49**	**4.44**	**4.31**	**-2.99**	**8.20**	**13.40**	**10.47**	**8.94**

Performance review

- The S&P/ASX Small Ordinaries Accumulation Index had a strong September quarter, rising 8.50%, with Industrials, Energy and Information Technology each recording double-digit gains for the quarter.
- The Ralton Smaller Companies portfolio added 12.94% for the quarter, outperforming the benchmark by 4.44% for the period.
- Stock selection within Materials (building construction), together with our overweight in Consumer Discretionary and underweight to Real Estate, each contributed to the outperformance.

Performance attribution

Key contributors

Key contributors	Positioning
iSelect Limited	Overweight
Cleanaway Waste	Overweight
Fletcher Building	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.

Cleanaway Waste (CWY, +40.0%) – CWY rallied strongly on a clean profit result, an improved capital position and evidence that CWY's turnaround strategy is working. The highlights from the result were: 1) strong cost control, particularly in the Industrials segment, 2) improved operating margins and cash flow outlook for the Melbourne Regional Landfill (MRL), and 3) an improved sales trends. On this last point, CWY had lost market share in waste collection to its major competitors in recent years, however various initiatives are gaining traction to drive market share and revenue growth. Given CWY has been a turnaround for some time, this was a particularly pleasing result as it saw delivery in a range of areas.

iSelect Limited (ISU, +49.4%) – ISU achieved its guidance target for FY16 and pointed to a strong outlook, confirming that the refocus of ISU under CEO Scott Wilson was on track. ISU hit rock bottom in January this year, when Wilson was forced to reveal the depth of the problems he had inherited from previous management, particularly in terms of call centre productivity. Wilson and his team have rectified the legacy problems, continued to deliver growth from a range of products (including outstanding growth from Energy and Broadband) and hit guidance. Delivery has seen a material re-rating of the stock price. With a strong and increasingly trusted brand for consumer service, ISU is likely to expand its product offering to meet demand. For example, ISU is now entering into credit card and travel insurance comparisons simply because consumers are visiting its website expecting ISU to offer these services. These customers are cheap to acquire for ISU as they are already visiting the website.

Fletcher Building (FBU, +25%) – NZ building materials company FBU, rallied after meeting the market's profit expectations and providing positive profit guidance for the coming financial year. Given we have a large weighting in FBU and have patiently supported CEO Adamson's restructuring efforts for several years, this was a pleasing result. FBU, although concentrated in NZ, has some 30 business units across four continents. After several years, it appears Adamson now has the portfolio of assets in good shape under trusted management.
As we witnessed on a recent trip to NZ, the economy is buoyant, driven by tourism and immigration (housing demand) and supported by a stable government with clear policies and a budget surplus. As Australians, we should pause and reflect on NZ's status! NZ government departments have money to spend and are looking to allocate capital to new projects, including infrastructure. These conditions are clearly supportive for FBU and hence the positive outlook. We continue to monitor the economic cycle in NZ as part of our investment thesis for FBU, although at present conditions remain favourable.

Key detractors

Key detractors	Positioning
ALE Property Group	Overweight
Graincorp Limited	Overweight
Fisher and Paykel Healthcare	Overweight

ALE Property Group (LEP, -4.8%) – shares in hotel property investment company LEP underperformed in a rising market. However, rolling year the shares returned a little over 19% 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.

Graincorp Limited (GNC, -9.0%) – corporate activity weighed on the GNC share price for the quarter. Specifically, major shareholder, Archer Daniels Midland, attempted to sell part of its near 20% stake via a broker-driven 'block trade.' The US corporate was however unhappy with bids that came back and pulled the sale. This has created an overhang in the shares, which may yet need to be 'resolved' before the shares move materially higher. Although GNC has diversified into both malt production and various food oil segments, GNC's legacy grain storage and export facilities on the east coast, together with grain trading operations, still make a healthy contribution to GNC's annual profit. Recent rains in Australia suggest the current winter crop should be a good one. This will benefit GNC this year, but more so in coming years, both from a rebound in grain exports and service provision, but also as the winter crop usually underpins 'carry-over' grain for the next season and financial years. The risk at this stage as we enter the key harvest period, is likely excess rain in various regions which can reduce crop quality and yield. Typically, only the best quality grains are exported.

Fisher and Paykel (FPH, +0.1%) – NZ medical device company, FPH tempered profit guidance for FY17 at its annual shareholder meeting (ASM), reducing profit guidance to the lower end of the previously expected NZ$165 to NZ$170m range, based solely on foreign exchange movements. The main contributor was strength in the NZ dollar. FPH also confirmed plans to expand its manufacturing plants in both NZ and Mexico, with a forecast for NZ$200m capital expenditure over the next four to five years. Such expansion plans are consistent with our expectations and highlight the exceptional growth opportunity FPH is pursuing. The shares were flat in a rising market and hence weighed on portfolio performance.

Portfolio changes

Key additions and material adjustments

Bought
Ainsworth Game Technology (AGI)
Australian Pharmaceutical Industries (API)
Vita Group (VGT)

We added three new stocks to the portfolio during the quarter, with each stock discussed below.

Australian Pharmaceutical Industries (API) - shares in API were a top contributor to the portfolio after being added during the quarter. 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 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 in the next one to two years.

Vita Group (VGT) – we took advantage of share price weakness intra quarter to acquire a position in telecommunications-focused retailer, VGT. VGT operates some 100 Telstra stores under a license agreement, equating to around one third of Telstra's shop footprint. TLS itself operates around 70 stores with various smaller operators controlling the balance. VGT sells both business and retail services and has a geographic bias towards regional and rural shops. We see several positive drivers for VGT from here, including store network growth and efficiency gains. Growth in stores is likely to come from

a shift towards TLS's business centre offering, along with consolidation of some of the non-VGT Telstra stores.

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.

Key disposals and material adjustments

Sold
Ardent Leisure (AAD)
SAI Global (SAI)
Sky Network Television (SKT)
Trade ME (TME)
BT Investment Management (BTT)

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.

SAI Global (SAI) – we sold our long-held position in SAI 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 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.

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.

Trade ME (TME) - we exited our small, but successful, investment in TME during the quarter. TME is a New Zealand-based online platform offering both general merchandise consumer sales, together with a broader advertising capability. TME is often described as NZ's version of eBay, SEEK and realestate.com rolled into one and is the dominant online trading platform in NZ. With TME having somewhat lost its way under Fairfax ownership, we purchased a position in TME, confident new management's reinvestment and brand refresh would be able to retain and grow both the user base and volume of product across TME's network. With the latest results largely confirming our views and the share price having re-rated, we elected to take profits in this name.

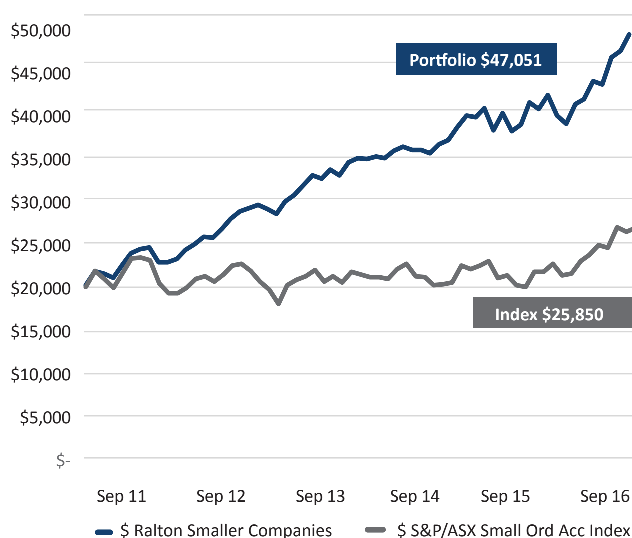
Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Staples	12.9%	6.5%	6.4%
Financials (ex-Property)	14.0%	8.0%	6.0%
Health Care	10.1%	7.1%	3.0%
Telecommunication Services	3.1%	1.3%	1.8%
Materials	21.9%	20.2%	1.8%
Energy	4.2%	4.0%	0.2%
Utilities	0.0%	0.7%	-0.7%
Industrials	10.0%	10.7%	-0.7%
Consumer Discretionary	18.6%	21.6%	-3.0%
Information Technology	2.7%	8.8%	-6.1%
Property	2.6%	11.2%	-8.6%
Total	**100.0%**	**100.0%**	

Top 10 holdings#

Company name	ASX code
Fletcher Building Limited (Australia)	FBU
Fisher & Paykel Healthcare Corporation Limited	FPH
Cleanaway Waste Management Ltd	CWY
Evolution Mining Limited	EVN
News Corporation	NSW
Nufarm Limited	NUF
Macquarie Atlas Roads Group	MQA
Tassal Group Limited	TGR
Steadfast Group Ltd	SDF
Orora Ltd	ORA

Performance comparison of $20,000*



CONTACT COPIA

1800 442 129 | clientservices@copiapartners.com.au | copiapartners.com.au

John Clothier	General Manager, Distribution	0408 488 549 | jclothier@copiapartners.com.au
Adam Tweedale	State Manager, Southern Region	0425 804 727 | atweedale@copiapartners.com.au
Angela Vincent	State Manager, Northern Region	0477 347 260 | avincent@copiapartners.com.au
Sean Paul McGoldrick	Account Manager, Northern Region	0421 050 370 | spmcgoldrick@copiapartners.com.au
Iain Mason	Director, Institutional Business	0412 137 424 | imason@copiapartners.com.au
Jacinta King	Business Development Associate	0413 962 922 | jking@copiapartners.com.au

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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 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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