Ralton Australian Shares
PERFORMANCE REPORT
31 May 2016

Total returns

At 31 May 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 Australian Shares	5.39	14.39	5.78	2.36	12.49	11.11	12.56	7.27
Income return	*0.60*	*1.29*	*2.03*	*4.02*	*4.01*	*4.34*	*4.32*	*4.39*
Growth return	*4.80*	*13.10*	*3.75*	*-1.66*	*8.49*	*6.76*	*8.24*	*2.88*
S&P/ASX 300 Accum. Index	3.14	11.67	6.60	-2.10	7.71	7.31	9.67	3.93
Difference	**2.25**	**2.72**	**-0.81**	**4.46**	**4.78**	**3.80**	**2.88**	**3.35**

Performance review

- The S&P/ASX 300 Accumulation Index continued its climb from its February lows, adding 3.14% in May, with Health Care and Information Technology the top performing sectors.
- The Ralton Australian Shares portfolio returned 5.39% for May, outperforming the benchmark by 2.25%.
- For the month, being overweight Consumer Discretionary and Health Care added both absolute value and relative outperformance for the portfolio.

Performance attribution

Key contributors

Key contributors	Positioning
Aristocrat Leisure Limited (ALL)	Overweight
Cybg PLC (CYB)	Overweight
QBE Insurance Group Ltd (QBE)	Overweight

Aristocrat Leisure Limited (ALL, +28.6%) – added significant value to the portfolio following a 20% upgrade to profit guidance for the 2016 financial year. The profit uplift was driven by a number of factors including market share gains in Australia and North America, continued growth in participation gaming machine installations (annuity-style income) and continued stellar growth for the Digital division (from a low base). This growth reflects the continued investment in product by ALL through its studio strategy. Looking forward, we believe ALL's operating momentum should continue while its main peers remain distracted by their own large-scale acquisitions. With a strong balance sheet and free cash flow, ALL has the option of increasing distributions or making another acquisition. We are comfortable with ALL pursuing acquisitions given its success integrating VGT and Product Madness.

Cybg PLC (CYB, +35.1%) – shares in mid-tier UK bank, Clydesdale and Yorkshire Banking Group, rose across the month as 'Brexit' fears eased and following the well-received half-year profit result – the first major update since CYB demerged from NAB earlier this year. The key driver of the strong result was the achievements on costs to date and the full-year guidance around costs. Specifically for the current year, CYB lowered its cost-to-income ratio guidance by a little over 2%, but also clearly stated its intent to continue to lower costs in the years to come. Given that the potential to lower the bank's cost-to-income ratio (from a very high 72% into the high 50s) was part of our thesis for adding to the holding post-demerger, this was a pleasing result. Other aspects of the result were broadly as expected and CYB has now made all key appointments of senior executives post the demerger.

One risk to any UK business at present is the pending Brexit vote or referendum in the UK which is focused on remaining in the European Union, scheduled for 23 June. We continue to monitor this event closely as we note that in the short term, there is potential for disruption to the UK financial system should a 'yes' vote occur.

QBE Insurance Group Ltd (QBE, +11.6%) – a well-received investor briefing in May, together with a currency tailwind from the falling Australian dollar, drove QBE shares higher in May. After several years of restructuring, QBE is now better positioned to produce reliable profit growth despite the soft premium environment and low interest rates. The insurance book has been materially de-risked, reinsurance restructured to reduce earnings volatility, productivity improvements have been delivered and the balance sheet is much improved (now positioned as equivalent to an S&P AA rating). Further, after many years of shrinking the business, QBE is now in a position to drive growth in its insurance business. The group should also deliver a strong and growing dividend yield over the coming years.

Key detractors

Key detractors	Positioning
AMP Limited (AMP)	Overweight
Speedcast International Ltd (SDA)	Overweight
The Star Entertainment Group (SGR)	Overweight

AMP Limited (AMP, -4.1%) – a disappointing market update from AMP at its AGM saw the shares underperform in a strong month for the market. The key negative from its update was further issues in its Wealth Protection division. Since AMP first identified problems in this division, the company has highlighted it would take time to work through the current policy issues in its life and income protection books. This has included restructuring products and pricing changes which all take time to work through the system. The update was disappointing as we thought the division's earnings had at least bottomed after the full-year 2015 results. However, the group's focus on reducing churn and allowing limited growth in the book should ultimately drive a material uplift in earnings. Our investment thesis for AMP is focused on the stabilisation of the Wealth Protection business and on its continued multi-year transformation and business simplification program. This simplification and efficiency drive has seen AMP continue to drive costs down so it can maintain margins even with the move to 'MySuper'. Also, AMP is seeing strong growth in AMP Capital as it continues to benefit from FUM flows from its international operations, in particular the Chinese joint venture.

Speedcast International Ltd (SDA, -13.3%) – shares in SDA were lower across May, tempered by cautious comments from management at the AGM who specifically flagged delays in terms of contract awards in the energy segment and their service start-up being pushed out. This in turn has been driven by the pressures on the oil industry at present. All the same, energy is a smaller part of SDA's business which primarily services the growing demand for telecommunications services to shipping lines and other remote business locations. As such, the current moderation of growth should only be temporary and we expect SDA to grow substantially through acquisition and organically in coming years.

The Star Entertainment Group Ltd (SGR, 0.0%) – shares in SGR, one of our larger holdings, was flat in a rising market and hence underperformed on a relative basis. For the rolling 12 months to the end of May, SGR has however returned 21%. Our medium-term view on SGR is that ongoing strong operational execution will see the Sydney casino continue to win local market share and underpin profit growth for its key asset. In QLD, SGR is now well positioned as it moves toward turning soil on the new casino and entertainment precinct at Queen's Wharf. From SGR's perspective, the project should provide a growth option in the medium term and given SGR is well partnered, the capital commitments for SGR are highly manageable.

Portfolio changes

Key additions and material adjustments

Bought
SAI Global Limited (SAI)
Boral Limited (BLD)
Sky Network Television Ltd (SKT)
Steadfast Group Ltd (SDF)

There were four new stock additions to the portfolio in May, each of which is discussed below.

SAI Global Limited (SAI) – we added a small position in SAI to the portfolio in May. SAI has had a busy couple of years with proposed takeover activity failing to complete, a short-lived CEO in Stephen Porges, an interim CEO in the form of Chairman, Andrew Dutton, and more recently in 2015, the internal appointment of Peter Mullins as CEO, who had previously headed up the SAI Property division. Over several meetings with the management team we have gained confidence about the strategic changes the CEO is making to the business and the future options for the Standards Australia (SA) contract (a key component of earnings the market currently has concerns about). Mullins is undertaking considerable organisational change, centred around familiar themes of improved efficiencies and business realignment.

On this last front, SAI has merged three key divisions under one banner and will look to capture synergies and in particular, drive the cross selling of services across assurance, compliance and standards. He is moving the business down the path where many of Australia's major professional service firms headed many years ago. This gives us a degree of comfort that his actions should drive future revenue and profit growth. Finally, in relation to SA, we understand there is a poor working relationship between SAI and its former parent SA (many will recall SAI was spun out of SA). As per the contract between the two parties, we expect SAI to continue to earn profit from the SA distribution agreement when the next contract phase begins in 2018, although we expect this to be at a far lower level of profitability.

Boral Limited (BLD) – we purchased a new position in the construction material and building products group, BLD. Mike Kane (MD) has done a good job restructuring the group and the business is positioned to benefit from: (a) the coming east coast rail and road infrastructure spending surge (offset in part by the slowdown in apartment developments); (b) the ongoing recovery in the US market; and (c) the growth from a low base in its Asian business for the Gypsum joint venture. Looking at these in more detail, the east coast infrastructure spend should boost demand for cement and asphalt. BLD is a key player in these markets and we believe it should be able to finally demonstrate pricing power given the scale of the planned projects. We sense BLD's US building products division, having turned the corner to profitability for the first time since 2006, can now be a beneficiary of the growth in US housing starts – annual new builds remain well below typical 'mid-cycle' volumes. Given the pain the US housing industry has gone through since the GFC, we expect BLD to deliver perhaps better profits from lower volumes given it is now a far more streamlined and slimmed down business. Finally, Kane was also instrumental in forming a joint venture between his former US employer and BLD's own international plasterboard division, creating the Gypsum joint venture. We believe Gypsum can continue to benefit in terms of growth from its lightweight product and opportunity set in key Asian markets.

Sky Network Television Ltd (SKT) – following share price weakness, we added NZ-based pay TV operator, SKT, back into the portfolio. Since we last owned the stock, SKT has been under pressure from cyclical factors, new competitors and rising content costs. In the pay TV space, our view is that content ownership is key and on this score SKT has 'locked up' all the key content Kiwis want to watch through multi-year agreements. The market remains concerned about the impact of competitors like Netflix, but SKT has had the benefit of watching what happened in other markets and learning from those experiences. SKT has locked up key content for sports (with the benefit of no anti-syphoning laws as we have in Australia), cable channels and movies, albeit at increased cost. This makes it very tough for competitors to get onto a path to profitability. While it will take time to play out, we felt the stock had been oversold by the market when we acquired the position on negative subscriber news.

Steadfast Group Ltd (SDF) – we acquired a small position in SDF, Australia's largest general insurance broker - a service provider and equity investor for insurance brokers in Australia, New Zealand and Singapore. SDF's broker network distributes general insurance products and related services to the SME segment of the market. SDF also operates a number of specialist insurance agencies focusing on businesses such as caravan parks and boutique transport operators. One of the key drivers of SDF's profitability is the position in the insurance premium cycle. SDF has been early in calling that we will see hardening insurance premiums in the Australian market given the lack of profitability in a number of key lines for insurers. Our discussions with other parties also suggest the premium cycle is hardening and this is an attractive point of the cycle to invest in an insurance broker as they take commissions on the rising premiums upfront (as opposed to insurance companies which earn the premium over time). At our recent meeting with management, we walked away impressed by the investment SDF is making in its service offering, and in particular, in its IT systems. All of this is very user friendly and designed to assist the brokers in accessing a full range of service options and ultimately, becoming more efficient. The group should also be able to continue down the path of acquiring more insurance broking businesses to further enhance growth.

Key disposals and material adjustments

Sold
Lend Lease Group (LLC)
Pact Group Holdings Ltd (PGH)

There were two outright sales from the portfolio, discussed below.

Lend Lease Group (LLC) – we exited one of our longer-held positions, LLC, during May. Operating results and execution on strategic objectives have been delivered in recent years and this has been pleasing. However, as we sit today, we felt that better opportunities existed outside the portfolio. As discussed above, BLD offers strong exposure to the pending infrastructure surge along Australia's east coast in particular, and although LLC via its construction business offers some exposure to this thematic, the impact on LLC is much smaller at a company level. Further, LLC is less likely to have the pricing power BLD is aiming to achieve. Secondly, we note the ongoing noise around the apartment-settlement risk that lies ahead of LLC. Specifically, Australian banks are pulling back on funding investors (at the direction of APRA) and foreign purchasers. In addition, mainland Chinese purchasers also face the problem that it is now much harder to move funds out of China than a couple of years ago when many of these purchase contracts were signed. While Chinese banks may step up and fund the settlement by the offshore borrowers, we have no visibility on the likelihood of this.

Pact Group Holdings Ltd (PGH) – we sold our relatively small position in PGH following a successful investment. The diversified packaging and manufacturing company has been a strong performer in terms of share price and hence we thought the current market multiple reflected fair value. We will look to revisit PGH should valuation become more attractive in the future.

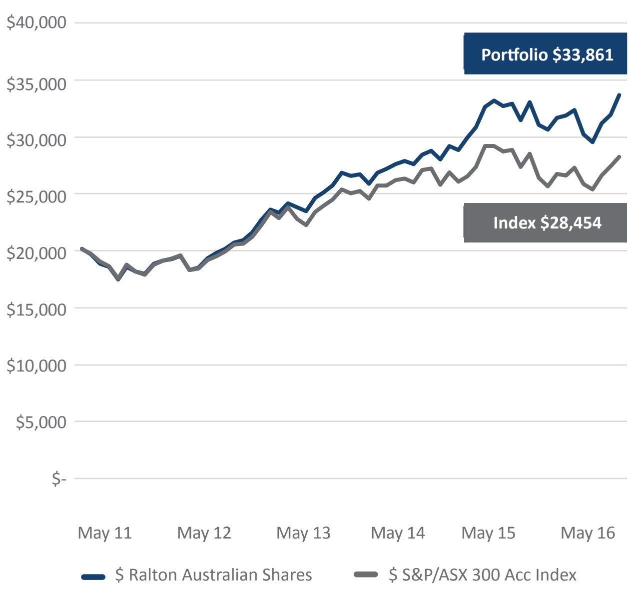
Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Discretionary	14.1%	5.2%	8.9%
Financials (ex-Property)	40.1%	36.6%	3.5%
Health Care	10.0%	7.3%	2.8%
Information Technology	3.4%	1.3%	2.0%
Industrials	8.7%	8.0%	0.7%
Energy	4.4%	4.1%	0.3%
Consumer Staples	6.8%	6.8%	0.0%
Materials	11.5%	13.7%	-2.2%
Utilities	0.0%	2.4%	-2.4%
Telecommunication Services	0.9%	5.5%	-4.5%
Property	0.0%	9.2%	-9.2%
Total	**100.0%**	**100.0%**	

Top 10 holdings#

Company name	ASX code
National Australia Bank Limited	NAB
Commonwealth Bank of Australia	CBA
Westpac Banking Corporation	WBC
Aristocrat Leisure Limited	ALL
QBE Insurance Group Limited	QBE
CSL Limited	CSL
ANZ Banking Group Ltd	ANZ
Star Entertainment Group Ltd	SGR
Sonic Healthcare Limited	SHL
Macquarie Atlas Roads Group	MQA

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.