Ralton High Yield Australian Shares
PERFORMANCE REPORT
30 June 2016

Total returns

At 30 June 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 Yeild Australian Shares	-3.58	2.10	-1.51	0.00	10.68	11.36	11.86	6.90
Income return	*0.83*	*1.53*	*2.98*	*5.24*	*4.85*	*5.13*	*4.97*	*5.02*
Growth return	*-4.41*	*0.57*	*-4.49*	*-5.24*	*5.83*	*6.23*	*6.89*	*1.88*
S&P/ASX 300 Accum. Index	-2.44	3.98	1.23	0.87	7.70	7.20	8.68	3.58
Difference	**-1.14**	**-1.88**	**-2.74**	**-0.88**	**2.98**	**4.15**	**3.18**	**3.32**

Performance review

- Despite Brexit-driven market volatility and share market falls at the end of June, the S&P/ASX 300 Accumulation Index finished the quarter up 3.98%. The Healthcare and Materials sectors (largely resources) were the top performers for the period, both adding more than 10%, while Consumer Staples was the only sector to record a negative return for the quarter.
- The Ralton High Yield portfolio finished the quarter up 2.10%, underperforming the benchmark by 1.88%.
- For the quarter, our bias to Consumer Discretionary stocks was favourable to performance, however being underweight resources as well as stock selection within Financials were both negative to portfolio attribution.

Performance attribution

Key contributors

Key contributors	Positioning
Aristocrat Leisure Limited (ALL)	Overweight
Sonic Healthcare (SHL)	Overweight
Pact Group Holdings (PGH)	Overweight

Aristocrat Leisure (ALL, +34.0%) – 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 further 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.

Sonic Healthcare (SHL, +14.8%) – in a somewhat unusual outcome, SHL was a beneficiary of regulatory change in Australia during the quarter. Your local GP, if they have a pathology lab on site, has likely been receiving rent for its pathology room well above the going market rate for similar space. The Federal Government has proposed to effectively re-regulate pathology collection centre rents. Such a proposal would see rental rates fall and revert to a market rent, saving the industry tens of millions of dollars. SHL and its industry support group have long lobbied for such reform. Proposed Federal Government pathology fee cuts from last December proved decidedly unpopular with the electorate, as this would have meant the imposition of co-payments by pathology companies to offset the lost revenue. By providing the rental cost cut to the pathology sector, pathologists will not need to impose co-payments (i.e. the burden now falls on the GPs). For SHL, we would expect the net outcome to be either neutral at a profit level, or perhaps an overall benefit – subject to the timing and degree of rental and staffing cuts.

This proposal appeared to provide clarity for SHL's Australian pathology operations, although we note the focus Medicare ("Mediscare") attracted during the Federal election and the sensitivity of the voting public to any changes – perceived or actual – to the government health system. To be very clear though, if the status quo remains, meaning no bulk billing fee cuts and no pathology collection centre rent reform, then for SHL this will have no material impact on its expected profitability.

Pact Group Holdings (PGH, +20.8%) – shares in PGH were boosted by two significant announcements during the period both of which focused on 'crate washing', which involves end-to-end management of a customer's container network. The containers may be somewhat bespoke, forming part of a manufacturing or transport process or perhaps something as routine as council bins. The 'pooling' network is similar perhaps to Brambles (CHEP pallets), whereby PGH controls the logistics, maintenance, repair and resupply of new containers as crates are damaged or lost. Firstly, PGH announced a new agreement for crate wash and pooling services agreement with an unnamed customer. The agreement remains subject to final approval between PGH and its customer, although once signed, we expect the scope of the deal to be material to PGH, requiring a reasonable amount of capital, and hence incremental returns. Secondly, PGH announced the acquisition of the Fruit Case Company (FCC) – a NZ-based crate pooling and hire business for $NZ21m. Clearly, PGH is keen on growing its presence in crate pooling - it is clearly within its manufacturing capability but also adds an annuity-style income stream as PGH is managing a network. PGH expects the FCC acquisition will meet its 20% investment hurdle (ROI) by year three.

Key detractors

Key detractors	Positioning
MG Unit Trust (MGC)	Overweight
Ardent Leisure (AAD)	Overweight
AMP Limited (AMP)	Overweight

MG Unit Trust (MGC, -52.2%) – although only a small position, our recent investment in the MG Unit Trust or 'Murray Goulburn' would have to rank as one of our most ill-timed investments. Despite our due diligence, it would appear the now former CEO and management had either unrealistic expectations at best, or at worst had completely misled the board and investors in an attempt to keep face and achieve the revised profit forecast for the current financial year. The profit downgrade reported by MGC in late April was highly material, triggered a revised milk price to dairy farmers for the current financial year and led to the CEO and CFO exiting the company. Taking a deep breath, while this was a very poor result for investors in the short term, the initial attraction and logic for our investment remains. MGC has access to key raw dairy ingredients and is looking to monetise this by value adding to the milk. This includes the build-out of manufacturing capacity to process milk into branded products, cheese, UHT, infant formula and whey, rather than powdered or regular milk product. We are sticking to our investment at this stage, and despite expecting some ongoing ructions within the company (such as director resignations) we expect value can be achieved from this name.

Since the resignation of the CEO, we have had the opportunity to meet the interim CEO. Reassuringly, his focus appears on stabilising the business, ensuring any inventory build is minimised and has, thus far, reiterated MGC's commitment to the existing business plan of which we were supportive. Since the profit downgrade, we increased our positon in MGC in a measured manner and pleasingly, the share price has recovered somewhat from its lows. We will continue to monitor the stock closely, as you would expect.

Ardent Leisure (AAD, -17.9%) – the share price of AAD drifted lower across the quarter to finish in line with where it traded in late February. Some investors are no doubt concerned about the growth rate the key US Main Event division is currently achieving given its exposure to the oil-focused US states such as Texas, and increased competition in its space, which in the short term is likely weighing on the stock. In March, the company announced its intention to divest the domestic 'Marine' assets, the d'Albora Marinas, and apply the proceeds to a faster rollout for the US Main Event centres. From our perspective, a relatively speedy sale process that still maximises the value of the marinas, which in turn allows for prompt acceleration of the US store rollout, should be well received by investors.

AMP Limited (AMP, -10.9%) – a disappointing market update from AMP at its AGM saw the shares underperform in a solid quarter for the market as a whole. The key negative from the AGM update was further issues in its Wealth Protection division. Since AMP first identified issues 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.

Portfolio changes

Key additions and material adjustments

Bought
Boral Limited (BLD)
Spark Infrastructure Group (SKI)
Aurizon Holdings (AZJ)
Computershare Limited (CPU)
Telstra Corporation (TLS)
Henderson Group (HGG)

There were several new stock additions to the portfolio during the quarter, each of which is discussed below.

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 is 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.

Spark Infrastructure Group (SKI) – the portfolio added a small position in SKI, which owns and manages regulated electricity distribution assets (i.e. the poles and wires) in Victoria and South Australia. Also, SKI was part of a consortium that purchased the Transgrid assets (a NSW-based poles and wires business) from the NSW state government last year. With recent regulatory decisions delivering a favourable outcome for SKI and the underlying assets, together with the recent sell-down of SKI's strategic equity holding in DUET Group (DUE), we expect that the enhanced free cash flow will allow SKI to increase its forecast distribution to investors in the near term.

Aurizon Holdings (AZJ) – following a pull-back in the share price, we added AZJ to the portfolio. AZJ is the former QR National or QLD railway company. AZJ has two key divisions, consisting of above-rail and below-rail assets. The above-rail assets or 'train sets' are focused on coal haulage for key miners with long-dated take or pay contracts to move both thermal and metallurgical coal from mines to port. AZJ has a dominant market share in QLD and also a material amount of contract work in NSW. The below-rail division consists of an extensive rail network, the majority of which is regulated and therein offers a consistent, predicable return profile to shareholders.

Despite the difficulty facing global coal markets and service providers to the industry, we believe AZJ is well placed. The company offers a mix of regulated returns and solid contracts for coal haulage and benefits from the relative positioning of QLD and NSW coal mines on global cost curves and their ability to endure tough industry conditions. Both divisions offer relatively consistent returns and represent strategic assets in terms of infrastructure exposure. AZJ management has done a good job in terms of improving productivity and improving margins post government privatisation and we believe it is capable of achieving its longer-dated margin targets.

Computershare Limited (CPU) – following the company's recent investor day, we added CPU to the portfolio. Investor concerns in recent times have focused on low growth from CPU's traditional registries business, together with a mixed track record on acquisitions and finally, the threat of new technology, such as 'Blockchain' to CPU's core business. The investor day highlighted an improved capital discipline, the sale and lease-back of CPU's Abbotsford head office and the future growth avenues for the company. As an illustration of growth opportunities, CPU recently confirmed a seven-year contract with UK Asset Resolution (UKAR) for mortgage processing services to look after the mortgage assets of the failed Northern Rock and Bradford & Bingley banks. CPU has confidence it can grow this business further in the UK. Finally, CPU's presentation around Blockchain actually highlighted the strength of CPU's technology offering and in time, how Blockchain could actually be an opportunity for CPU.

Telstra Corporation (TLS) – following share price weakness we added TLS back into the portfolio. TLS has the dominant mobile phone network and the dominant position in the broadband market. Although, TLS has had a spate of network issues over the last six months which will likely see a lift in customer churn in its mobile business despite its efforts to appease customers with 'free demand days' etc. TLS's traditional core networks business is winding down. For this reason, TLS will receive a series of payments associated with the migration of the national network to the NBN in the coming years. These cash flows support and underpin a likely strong dividend payment from TLS and the reinvestment required to replace the earnings stream from the wind down of the core network business. This includes the growth in its NAS business, international operations, investment in healthcare-related service business, a range of start-ups and the media business. This re-investment risk is one of the key reasons we believe TLS's share price has been held back relative to its other high yield peers. It will take some time for the capability of the group to reinvest the free cash flow to become clear. However, in the interim, TLS offers an attractive yield at a reasonable price.

Henderson Group (HGG) – finally, we added a small position in HGG post the Brexit vote. Henderson is a UK-based fund manager with operations and investment products across several regions, although the focus is predominantly on the UK, EU and US. HGG's products cover equities, property and fixed incomes, with this latter exposure particularly important as it balances out its investment portfolio risk. Part of our logic had been that if bond yields continue to be low for much longer, investors would be forced further into risk assets. HGG obviously offers plenty of exposure across the asset classes. We felt that in the event of Brexit, the lower rate, particularly for the UK and Europe, could be in place for even longer. While we had expected some downside after Brexit and market volatility, we had not expected greater concerns would emerge in the markets about Deutsche Bank/Credit Suisse and the obstinance of the EU authorities to Italy dealing with the US$200bn+ of bad debts in its banking system. This has all exacerbated the negative outlook for European growth and the financial services sector after Brexit. As such, we are keeping a close watch on events to either increase the position further if markets stabilise or exit if the conditions in the banking system look likely to cause more systemic issues in Europe.

Key disposals and material adjustments

Sold
Lend Lease Group (LLC)
CSL Limited (CSL)
Super Retail Group Ltd (SUL)
Virtus Health (VRT)

There were four outright stock sales from the portfolio during the month, namely CSL Ltd (CSL), Lend Lease (LLC), Super Retail (SUL) and Virtus Health (VRT).

Lend Lease (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.

CSL Limited (CSL) – shares in blood plasma producer, CSL, have been a strong performer for the portfolio, benefiting from good growth in the base plasma (blood) business, strong growth in various emerging markets and a positive track record in research and development of late. The latter has culminated in recent regulatory approvals and pending product launches for key recombinant products in the haemophilia segment, marking a step-change in patient treatment options for the CSL portfolio. With these positives now better reflected in the CSL share price and the dividend yield payable on shares falling, we elected to take profits in this name.

Super Retail Group Ltd (SUL) – after reducing the position following a poor profit result for SUL in February, we fully exited the stock in early April. We still harbour concerns as to management's ability to improve returns from the Leisure segment and also note the potential for larger scale foreign players in the mass sports category to impact on returns and market share gains for both Rebel Sport and Super Amart.

Virtus Health (VRT) – shares in the IVF provider performed strongly in April and had recovered approximately 45% off last year's lows. Much of this rebound has been driven by a stabilisation in demand for IVF services in Australia in the last 12 months, with a return to reasonable growth in patient demand in most Australian states. Despite rising competition, including new clinics being opened by Primary Healthcare (PRY), VRT appears to have suffered little in the way of market share losses. However, with the rally in the share price and VRT no longer offering a material dividend yield, we elected to exit our holding in VRT.

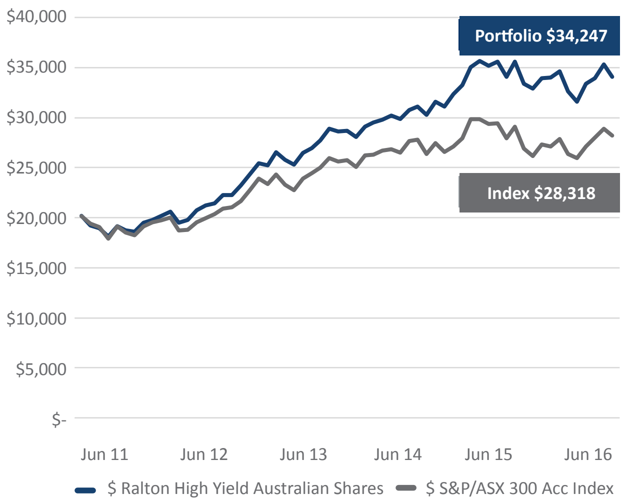
Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Discretionary	12.7%	5.3%	7.5%
Financials (ex-Property)	40.8%	36.5%	4.3%
Consumer Staples	9.8%	6.8%	3.0%
Information Technology	2.9%	1.3%	1.5%
Utilities	3.5%	2.4%	1.1%
Energy	4.3%	4.0%	0.2%
Telecommunication Services	4.8%	5.5%	-0.7%
Industrials	6.9%	8.1%	-1.1%
Materials	11.1%	13.6%	-2.5%
Health Care	3.3%	7.3%	-4.1%
Property	0.0%	9.2%	-9.2%
Total	**100.0%**	**100.0%**	

Top 10 holdings#

Company name	ASX code
Westpac Banking Corporation	WBC
National Australia Bank Limited	NAB
Commonwealth Bank of Australia	CBA
Aristocrat Leisure Limited	ALL
QBE Insurance Group Limited	QBE
ANZ Banking Group Ltd	ANZ
Telstra Corporation	TLS
Macquarie Atlas Roads Group	MQA
AMP Limited	AMP
Coca-cola Amatil Limited	CCL

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 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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