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 Australian Shares	-4.99	2.67	-1.00	1.90	11.19	10.52	11.35	6.55
Income return	*0.66*	*1.26*	*2.62*	*4.67*	*4.17*	*4.48*	*4.40*	*4.43*
Growth return	*-5.65*	*1.41*	*-3.62*	*-2.77*	*7.02*	*6.04*	*6.95*	*2.12*
S&P/ASX 300 Accum. Index	-2.44	3.98	1.23	0.87	7.70	7.20	8.68	3.58
Difference	**-2.55**	**-1.31**	**-2.24**	**1.02**	**3.50**	**3.32**	**2.67**	**2.97**

Performance review

- Despite Brexit-driven market volatility causing a market fall near 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 the Consumer Staples sector was the only one to record a negative return for the quarter.
- The Ralton Australian Shares portfolio returned 2.67% for the quarter, underperforming the benchmark by 1.31%.
- For the quarter, being overweight Consumer Discretionary was a strong contributor to returns, offset by our underweight to Materials (largely resources) and finally, our stock exposures within Financials were a detractor from portfolio performance.

Performance attribution

Key contributors

Key contributors	Positioning
Aristocrat Leisure Limited (ALL)	Overweight
SKY Network Television (SKT)	Overweight
Sonic Healthcare (SHL)	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.

SKY Network Television (SKT) – SKT added value to the portfolio after we initiated a position during the quarter. 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.

Our view on the value of SKT's position, namely its content and distribution capability, was vindicated quite quickly with SKT and Vodafone NZ – the local arm of the global Telco major – agreeing to a merger. This is an obvious transaction from our vantage as it allows the combined entity to offer its customers a triple play, namely pay TV, mobile and terrestrial telephony services. Globally, pay TV companies such as SKY in the UK, have demonstrated the benefits of offering the triple play and hence why the transaction makes sense. Further, we note Vodafone in the Netherlands is pursuing a similar strategy with the domestic pay TV operator, with the terms of the merger appearing reasonable from an SKT shareholder perspective. However, the deal will have to pass muster with the NZ competition regulator, the NZCC. Assuming this occurs, we see value in the merged SKT entity given the discount at which the stock trades relative to global peers.

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.

Key detractors

Key detractors	Positioning
Ardent Leisure (ALL)	Overweight
AMP Limited (AMP)	Overweight
The Star Entertainment Group (SGR)	Overweight

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.

The Star Entertainment Group (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 June, SGR has however returned 24%. 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. Our investment view is further supported by ongoing growth in tourism into Australia, particularly from Asia, with casinos being a key beneficiary. Tourism is currently one segment of the economy that is expanding, benefits from the falling Australia dollar and hence supports domestic GDP in the face of ongoing declines in the mining sector.

Portfolio changes

Key additions and material adjustments

Bought
SAI Global Limited (SAI)
Boral Limited (BLD)
Steadfast Group Ltd (SDF)
Telstra Corporation (TLS)
Henderson Group (HGG)
Sky Network Television (SKT)

There were several new stock additions to the portfolio in the June quarter which we have discussed below, other than **Sky Network Television (SKT)** which has already been considered above.

SAI Global (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 (Chairman, Andrew Dutton) and then the internal appointment of Peter Mullins as CEO, who had previously been the head of 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.

SAI has merged the three key divisions under one banner and will look to capture revenue synergies by driving the cross selling of services across Assurance, Compliance and the Standards business lines. 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 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.

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, 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.

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)
Pact Group Holdings Ltd (PGH)
Virtus Health (VRT)

There were three outright sales from the portfolio during the quarter, discussed below.

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, we felt 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 (PGH) – we sold our 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.

Virtus Health (VRT) – finally, with recent share price strength in IVF provider, VRT, marking an approximate 45% recovery off last year's lows, we elected to take profits in this name. 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.

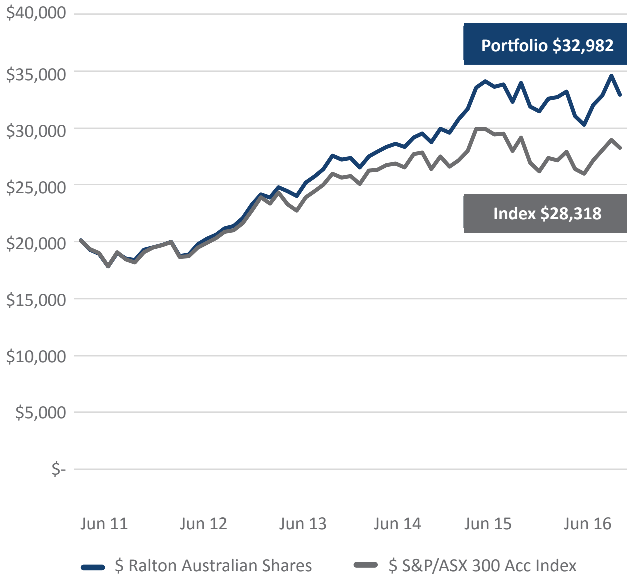
Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Discretionary	14.3%	5.3%	9.0%
Financials (ex-Property)	40.0%	36.5%	3.4%
Health Care	10.2%	7.3%	2.8%
Information Technology	3.4%	1.3%	2.1%
Industrials	8.7%	8.1%	0.7%
Energy	4.3%	4.0%	0.3%
Consumer Staples	6.8%	6.8%	0.0%
Materials	11.4%	13.6%	-2.2%
Utilities	0.0%	2.4%	-2.4%
Telecommunication Services	1.0%	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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Performance of the Ralton Wholesale 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.

#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.