Total returns

At 31 March 2017	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	4.11	5.90	12.32	21.82	11.41	15.39	10.40	8.39
Income return	*0.85*	*1.65*	*2.31*	*5.34*	*4.77*	*4.91*	*4.95*	*5.02*
Growth return	*3.27*	*4.26*	*10.01*	*16.48*	*6.64*	*10.48*	*5.45*	*3.36*
S&P/ASX 300 Accum. Index	3.28	4.71	9.88	20.24	7.51	10.83	7.20	4.94
Difference	**0.84**	**1.19**	**2.44**	**1.58**	**3.90**	**4.55**	**3.20**	**3.45**

Performance review

- The S&P/ASX 300 Accumulation Index added 4.71% for the March quarter, with Health Care and Utilities the top-performing sectors. Telecommunications was the only sector to record a negative return for the quarter.
- The Ralton High Yield portfolio finished the quarter up 5.90%, outperforming the benchmark by 1.19%.
- For the March quarter, the portfolio's overweight position in both Consumer Discretionary and Consumer Staples added value. Being underweight Health Care in the portfolio detracted from relative returns during the period.

Performance attribution

Key contributors

Key contributors	Positioning
Aristocrat Leisure	Overweight
AGL Energy Limited	Overweight
Costa Group Holdings	Overweight

Aristocrat Leisure (ALL, +15.9%) – shares in ALL rallied after management upgraded profit growth for the coming year to between 20 - 30% at the AGM in late February. Although the company did not detail the key drivers, we expect sales are being driven by market share gains in the US market across its participation gaming business (annuity-style income) and its outright sales segment. This upgrade has come before the company releases product into new segments of the US market, which we also expect could drive further upside. An upgrade this early in the year is a positive signal as it suggests ALL has good visibility on the outlook. ALL also confirmed the new CEO, Trevor Croker, has received all necessary regulatory approvals to take up the position. This is an important hurdle in such a highly regulated industry.

AGL Energy (AGL, +19.4%) – was a strong contributor to portfolio returns during the quarter. The main driver of the share price has been the rise in electricity prices. Specifically the 'forward curve' for electricity prices has risen by 30% or more in recent months for most Australian states. This has been driven by expectations of a tight market for electricity as Hazelwood power station is closed. The sharp rise in power prices over the past couple of years is a result of the communities' decision to increase the level of renewable energy in the system, but politicians failing to get the policy settings right over the last decade to implement a strategic plan for the industry to undertake the transition. This means AGL is generating a form of super-profits given its large low-cost, base-load power generation capability. This was a predictable outcome, however the solutions for the problems in the system are going to take many years to resolve. As these price increases start to get passed through to the customer, there is a risk of a political backlash. While the fundamentals for the stock look very strong, the potential for an irrational regulatory response means we need to keep the holding size in check (despite our optimism).

Costa Group Holdings (CGC, +26.5%) – shares in horticultural company, Costa, rallied after the company announced both an increase in profit guidance for the current year and a $65m expansion of its mushroom farm at Minarto in South Australia. Costa is already the number one player in the Australian mushroom category and this expansion will further consolidate its position and allow Costa to participate in future consumption growth. Costa's basket of produce includes avocados, blueberries, raspberries, mushrooms and tomatoes and aligns with our thematic views in regard to 'premium' food categories and healthy eating. Costa has several growth avenues, including capacity expansions for most of the categories just listed, together with further acquisitions in the fast-growing avocado segment and finally, offshore growth via its berry farms in both Morocco and China.

Key detractors

Key detractors	Positioning
Ainsworth Gaming	Overweight
Telstra Corporation	Overweight
BHP Billiton	Overweight

Ainsworth Gaming (AGI, -12.8%) – the turnaround in gaming manufacturer, AGI, has been slower than the market had expected and so the stock underperformed for the quarter. Following last October's profit downgrade, the half-year earnings result for FY17 was consistent with the guidance provided at that time. AGI has been suffering from the strong performance by Aristocrat (another portfolio investment) for several years. We are of the view AGI is close to seeing a bottom in its sales in the Australian market and it is making positive strides in growing its US business. This has involved lifting R&D spending and making additional investment in US management, facilities and sales staff, which are yet to deliver a return. Novomatics, a major European gaming player, is in the process of obtaining approvals to take a 53% stake in AGI. There are cost and revenue synergies that will also emerge over the next few periods. So the turnaround will be bumpy, but it appears to us to be underway.

Telstra Corporation (TLS, -8.6%) – shares in Australia's largest telecommunications company, TLS, were impacted by a mixed profit result at the half-year announcement, with mobiles the key source of short-term disappointment. In the short term, it appears that competition in this space his ticked up somewhat. Our somewhat contrarian view on TLS is that the NBN earnings hole that will develop as the government rolls out the NBN network can be filled via a combination of both cost savings within TLS and growth in its other divisions. Last August's announcement of a $3bn capital expenditure boost including several initiatives that are targeting both productivity and cost savings, further consolidate TLS's dominant mobile network advantage and make strategic sense. These mobile initiatives are expected to allow TLS to maintain profit growth in mobile as a key growth driver of TLS overall. In this respect, we will be monitoring the progress of mobile and NBN margin levels over coming periods as this is key to our thesis.

BHP Billiton (BHP, -4.1%) – shares in the diversified mining and energy company pulled back from recent gains in the quarter, with no real driver behind the movement, and therein detracted from performance. Commodity prices traded mostly within a modest range across the period, but importantly remain well above the lows of 12 months ago. The BHP of today under CEO, MacKenzie, is a smaller, more focused investment proposition than its predecessor of five years ago. The bulk of BHP's smaller, non-tier one assets have been either sold or divested into S32, which holds the aluminum, alumina, manganese and other smaller assets in coal, silver and zinc. BHP is focused on its tier one, long-life assets which are focused on iron ore, coking coal, copper and petroleum. Post the resources boom, BHP has reduced capital expansion and honed in on productivity improvements and cost savings, effectively sweating the production of its existing assets at lower costs. This program now sees BHP with a solid capital position and modest growth opportunities. Should current commodity prices remain for even the short term, this would increase the likelihood of further capital management for BHP shareholders.

Portfolio changes

Key additions and material adjustments

We purchased three new stocks during the quarter.

Bought
Caltex Limited (CTX)
Ansell limited (ANN)
Japara Healthcare (JHC)

Caltex Limited (CTX) – has undergone considerable structural change in recent years, with the business shifting from being a capital-intensive refiner toward a more capital light operation focused on fuel retailing and fuel distribution. The fuel distribution network supplies a range of fuels (diesel, petrol and specialist products), servicing CTX's own retail network, providing wholesale fuel to third parties and is also a material supplier of fuel to large-scale commercial customers, such as miners. CTX shares have been weaker following the proposed sale of Woolworths' fuel retailing business to BP, which will likely see CTX lose most of its sales to those petrol stations. Although this was a negative for earnings, the decline in the share price created an opportunity to invest. We expect CTX to strive to replace the lost profits and note it has made two small acquisitions recently which assist in partly filling the earnings gap. CTX is well capitalised, providing potential for further acquisitions, further investment in CTX retail locations or alternatively capital management (there is large pool of franking credits).

Ansell limited (ANN) – we added a small position in Ansell in February. Under CEO, Nicolin, ANN has had a mixed operating performance with strategic acquisitions, significant restructuring and refocusing of the organisation offset by manufacturing hiccups and tepid end market demand. In this setting, we now feel ANN is in somewhat clear air. The long-executed transition of ANN's glove range from commodity to specialised product (with the peak of the transition now passed) should see a return to more sustainable revenue growth for the group. ANN have also announced an intention to exit the Sexual Wellness business. Proceeds are likely to be reinvested in further specialised product segments or returned to shareholders. Further, we have a positive view on recent supply agreements that ANN has entered with key distributors in several of its key markets. These mutual relationships have the potential to consolidate ANN's position as the number one player in specialised safety-related gloves and associated protective wear.

Japara Healthcare (JHC) – we have purchased a position in aged care operator, JHC, providing the portfolio with exposure to the strong thematic of Australia's ageing population and its need for high acuity care that many Australians will require. Aged care, unlike retirement village living, is not a discretionary decision for many. JHC is also seeking to grow its total bed numbers via expansion of its own existing facilities or through the construction of new facilities. The latter requires the award of bed licences from the government and JHC has received approximately 1,000 of these so far. Also, we are seeing a shift in consumer behavior as many residents (and family) are now expecting to pay for a higher level of comfort and care in the final years of life. This provides an additional revenue opportunity for JHC.

We note two sources of recent share price weakness for the aged care sector. First, peer company, **Estia Health Ltd (EHE)** experienced a high-profile change in management and dilutive capital raising owing to its poor balance sheet after a debt-fueled string of acquisitions. We do not believe JHC has any such concerns, given the conservative positioning of its balance sheet. Second, a series of government-driven fee changes and focus on resident service levels in 2017, ensuring nursing home operators are not overcharging for services provided (care level) to patients, weighed heavily on the sector. Regulatory risk will always be a concern with an investment in this sector, particularly given the government is a major funder and people tend to blame politicians for every issue in the sector! However, we are of the view our entry price compensates for the risk. History tells us that fee pressures and regulatory risk are supportive of corporate players over the medium term as corporate players bring operating scale and funding capability to the sector, can benefit from consolidation as smaller players and have an interest in protecting their reputations. At present, aged care is largely a cottage industry, with the market dominated by smaller players and not-for-profits.

Key disposals and material adjustments

Sold
Incitec Pivot (IPL)
Duet Group (DUE)

We sold our long-held position in **Incitec Pivot (IPL)** during January. With the long-awaited US ammonia plant, known as 'Waggaman', having recently commenced operations and the price for ammonia, urea and DAP all bouncing off recent lows, we took the opportunity to exit the position capturing the solid move in the share price arising from these changes. Our pragmatic view, taking into account several of the volatile inputs and moving parts that typically influence IPL's customers, end markets and share price, is that the risk reward was now less favourable.

Duet Group (DUE) – shares rallied early in December on news it had received a proposal from Cheung Kong Infrastructure (CKI) to acquire 100% of the shares in DUE. We took the share price reaction as an opportunity to reduce our holding at the time and subsequently have exited the position entirely. In January, the DUE board recommended the CKI proposal to shareholders. The bid however remains subject to various approvals, including the Foreign Investment Review Board (FIRB). In the current climate, noting FIRB processes, including recent precedents and the likely long-dated nature of any bid process before eventual cash receipts for our investors, we have a cautious view on any foreign-led bid proceeding. This was a key factor in our decision to sell and capture profits, together with the implied valuation multiple DUE was now trading at.

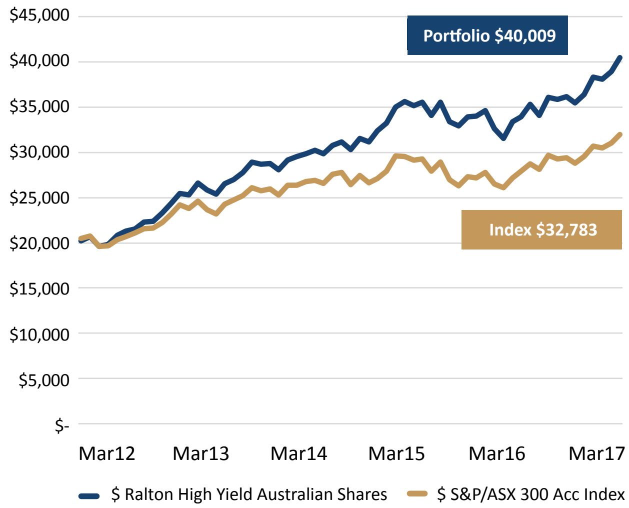
Sector allocation

GICS sector	Ralton	Index	+/-
Consumer Staples	12.3%	7.2%	5.0%
Consumer Discretionary	8.7%	5.0%	3.8%
Energy	7.3%	4.3%	3.0%
Information Technology	3.2%	1.2%	1.9%
Telecommunication Services	5.1%	4.0%	1.2%
Materials	16.6%	15.6%	1.0%
Utilities	2.9%	2.7%	0.2%
Health Care	4.6%	6.8%	-2.2%
Industrials	4.1%	6.7%	-2.6%
Financials	35.2%	38.2%	-3.0%
Real Estate	0.0%	8.4%	-8.4%
Total	**100.0%**	**100.0%**	**0.0%**

Top 10 holdings#

Company name	ASX code
Westpac Banking Corp	WBC
BHP Billiton Limited	BHP
Commonwealth Bank of Australia	CBA
National Australia Bank Limited	NAB
Aristocrat Leisure Limited	ALL
Woolworths Limited	WOW
Telstra Corporation	TLS
ANZ Banking Grp Ltd	ANZ
QBE Insurance Group Limited	QBE
Coca-Cola Amatil Limited	CCL

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.

#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.