

## Total returns

| At 30 September 2017     | 1 mth %      | 3 mths %     | 6 mths %    | 1 yr %      | 3 yrs % p.a. | 5 yrs % p.a. | 7 yrs % p.a. | Inception % p.a.<br>(Feb 2008) |
|--------------------------|--------------|--------------|-------------|-------------|--------------|--------------|--------------|--------------------------------|
| Ralton Australian Shares | -0.27        | -0.43        | -0.26       | 11.50       | 10.72        | 13.76        | 10.61        | 7.54                           |
| Income return            | 0.60         | 1.46         | 1.91        | 3.82        | 3.69         | 3.83         | 4.15         | 4.33                           |
| Growth return            | -0.86        | -1.88        | -2.17       | 7.68        | 7.03         | 9.92         | 6.46         | 3.21                           |
| S&P/ASX 300 Accum. Index | 0.04         | 0.80         | -0.78       | 9.02        | 7.12         | 9.94         | 7.68         | 4.59                           |
| <b>Difference</b>        | <b>-0.30</b> | <b>-1.23</b> | <b>0.52</b> | <b>2.48</b> | <b>3.60</b>  | <b>3.81</b>  | <b>2.93</b>  | <b>2.95</b>                    |

## Performance review

- The S&P/ASX 300 Accumulation Index finished 0.80% higher for the quarter. Strength in Energy and Materials added value to the benchmark, with Telecommunications the key negative sector.
- The Ralton Australian Shares portfolio returned -0.43% for the September quarter, underperforming the benchmark by 1.23%.
- For the September quarter, being overweight Energy added value to the portfolio, offset by our overweight to Consumer Staples and underweight to the resources heavy Material Sector.

## Performance attribution

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) and provide outlook commentary on the period ahead.

### Key contributors

| Key contributors   | Positioning |
|--------------------|-------------|
| Worley Parsons Ltd | Overweight  |
| IOOF Holdings Ltd  | Overweight  |
| Santos Ltd         | Overweight  |

**Worley Parsons Ltd (WOR, +20.3%)** – in line with our investment thesis, Worley’s FY17 profit result confirmed a stabilisation in revenues, solid EBIT margins and improved cash flows, including the collection of outstanding payments from various sovereign clients. This confirmed that WOR has been successful in adjusting its cost base in the face of a downturn in its core hydrocarbons market. The outlook for WOR remains positive, with a bottoming in its global clients’ capital expenditure budgets, an improving win rate on large tenders and management expecting to retain savings which will boost margins as demand returns. Visibility on the strength and timing of any uptick in demand remains limited and dependent on the vagaries of oil price movements. This continues to check our position size on the WOR investment and we elected to take some profits in August. We continue to monitor OPEC supply cuts closely.

**IOOF Holdings (IFL, +13.8%)** – a solid profit result for IOOF, boosted by strong industry FUM flows and the benefit of an increase in the number of financial planners operating under the IFL banner, was well received by investors. This profit number was supported by cost savings called out by the CFO at the half year result and delivered in spades for the second half of the year. It was pleasing to see the growth in planner numbers as we believe this reflects the attractiveness of the IOOF platform. As we have written previously, IOOF has worked extensively on the flexibility of its investment platforms which allows advisers to personalise investment services rather than being restricted to in-house product offers. We like IOOF’s focus on the customer which differentiates it from the big banks and other large financial institutions.

**Santos Limited (STO, +32.7%)** – progress made on the strategic front, together with the operational turnaround under CEO Gallagher drove gains in the STO share price over the quarter. The key highlights from the first half results were evidence of reduced drilling costs and improved production results, namely gas flows from key fields. Together with interest savings and productivity and efficiency measures across the organisation, this resulted in lower free cash flow breakeven for oil equivalent production of US\$33 during the period. At current oil prices, this drove solid free cash flow and debt reduction. If STO can continue to maintain and improve the efficiency of its operational and capital expenditure processes this will drive reserve upgrades for STO’s gas fields.

At a more strategic level, STO continues to advance various growth projects and simplify its organisation and capital structures. Enhanced gas production and flexibility has enabled STO to write new gas supply contracts and enhance flexibility within its own Horizon gas contract with GLNG. Such contracts and similar moves by peers, including diversion of gas from export LNG markets toward domestic supply appears to have reduced sovereign and regulatory risk in relation to the government’s export gas reservation policy. This redirection of gas was very much as we had envisaged, although rational outcomes and government policy are not always correlated. Curiously, domestic spot prices for

gas have fallen in recent months and international export prices have risen. It is a market place after all!! Critically, we believe that STO is now well placed to deal with such pressures, emphasising the importance of better drilling results and the flexibility it ensures.

#### Key detractors

| Key detractors      | Positioning |
|---------------------|-------------|
| QBE Insurance Group | Overweight  |
| Aristocrat Leisure  | Overweight  |
| iSelect Ltd         | Overweight  |

**QBE Insurance Group (QBE, -15.2%)** – QBE’s half year profit and guidance were a further disappointment to investors after downgrades in full year profit guidance in June, with losses in emerging markets continuing to be an issue for the company. Unfortunately, this comes on the back of a raft of profitability concerns in various segments over recent years. Each time, QBE has promised to address or divest the offending business and appointed new management, but new problem areas have consistently sprung up from unexpected corners. Although some blame can certainly be laid at the feet of management and the type of insurance business being written, the global industry has been under pressure for some time, impacted by excess liquidity globally and the lack of fixed income returns. We see it as inevitable that these pressures ease – typically a major insurance event, such as a US cyclone, creates extensive industry losses and sees a return to more rational pricing, often involving an increase in insurance policy coverage.

In this context, the misses we keep seeing by QBE are a function of the fact it has no buffers left after such a long period of revenue decline. Investor confidence in QBE is low despite a five-year program of cost-out success, a turn up in premium rates, reinsurance efficiencies and faster than expected portfolio remediation in Australia. This series of events has resulted in CEO change, with John Neal being replaced by current CFO Pat Regan. We will continue to monitor improvements in the global premium cycle and interest rates to determine the positioning going forward.

**Aristocrat Leisure (ISU, -6.9%)** – ALL shares underperformed in the quarter, giving back some recent gains, although the price remains some 32% higher rolling year to the end of September. We attribute the recent share price movement to a mixture of investors taking profits following strong capital returns, and the circa 2.5% appreciation in the Australian dollar against the US dollar during the September quarter (ALL’s key operating currency). We continue to see positive momentum for ALL’s US participation and outright sales businesses. Additionally, ALL has several new products, including the Class III stepper, targeting new segments

of the market. At this early stage, the new products are receiving positive reviews in the market. Further, ALL’s Digital offering continues to go from strength to strength with ongoing growth for the Heart of Vegas platform and positive early signs for its new Cashman app.

**iSelect Limited (ISU, -20.4%)** – ISU’s FY17 profit met the company’s forecast earnings range for the financial year, though fell some \$1.5m short of the top of its guidance. The ‘shortfall’ was driven by some consumer softness in the fourth quarter in the Energy and Telco sector, a smaller tax-driven private health insurance push in late June and increased investment in its South African consultant centres, which was a decision made in March against a slightly more positive trading backdrop. The market’s disappointment was severe as investors quickly revisited the credibility issues of the ‘old ISU’ and wiped a good portion of the last year’s share price gains from ISU’s value. In the medium term, we believe that ISU’s offering to consumers, relationship with key product providers, increasing diversification of earnings streams and the positive steps taken by the management team have not disappeared. The net cash backing of the balance sheet, ongoing share buyback and valuation support add strength to our conviction. We will be looking for positive signals that ISU remains on track to hit FY18 targets before increasing our position.

#### Portfolio changes

##### Key additions and material adjustments

| Bought           |
|------------------|
| Wesfarmers (WES) |
| Nufarm Ltd (NUF) |
| AGL Energy (AGL) |

We added three new stocks to the portfolio in the September quarter, namely **Nufarm Ltd (NUF)**, **Wesfarmers (WES)** and revisited **AGL Energy (AGL)**.

Recent dry weather conditions in the United States have weighed on global agricultural stocks, providing us with an opportunity to add a small position in agricultural specialist **Nufarm Ltd (NUF)** as the share price weakened. Seasonal variances are part and parcel of investing in the agricultural sector, however our thesis regarding Nufarm relates more to the material turnaround that CEO Greg Hunt has driven in the business. Over several years, Hunt and his team have delivered on a multi-pronged \$100m cost saving initiative, featuring consolidation across its manufacturing footprint, procurement and supply chain savings and material improvements in cash management and return on equity.

Nufarm under Hunt is a well-focused business, diversified by product, region and market segment. The business is

now in a far stronger position than it was several years ago and is well positioned to take advantage of growth opportunities. These opportunities include participation in global M&A (arising from consolidation amongst larger global players), monetization of NUF's Omega-3 seed program or simply targeting further cost savings and improvements in cash collection. Given this optionality and with the share price reflecting some seasonal risk in the short term, we began to build a position in NUF.

We added a position in Australian conglomerate **Wesfarmers (WES)** to the portfolio in August. Although perhaps needing little introduction, we would remind investors that WES owns retail operations across Coles supermarkets, 'category killer' Bunnings, Kmart, Target and Officeworks, in addition to industrial, chemical and coal mining operations. Coles and Bunnings are the biggest contributors, each accounting for nearly 30% of annual WES profits.

The shares have traded sideways in recent times, impacted by the resurgence of Woolworths' supermarkets under Brad Banducci and Aldi's expanding footprint in Australia. This competitive dynamic has seen Coles somewhat on the back foot, with sales and margin momentum pressured. Assuming that a price war does not break out amongst the supermarket majors, we expect Coles to be able to re-focus its own business and produce solid profitable returns. Bunnings and Kmart remain market leaders, which together with a potential turnaround in Target and reasonable outlook for Asian coal pricing informs our positive view on WES. WES retains a very healthy balance sheet, is paying out a high portion of annual profits as fully franked dividends and trades at an attractive valuation in the current market.

**AGL Energy Limited (AGL)** – having sold our AGL position the June quarter, share price weakness gave us an opportunity to revisit this name. We see several supportive features of an investment in AGL. Firstly, AGL has made considerable progress in driving productivity improvements to boost profits. Secondly, the increased use of renewable energy in the electricity markets is driving up the wholesale electricity price to the benefit of low cost electricity producers such as AGL. Finally, AGL's balance sheet is in good shape after recent asset sales. AGL is well positioned to either return capital to shareholders or alternatively pursue acquisitions.

Nonetheless, we highlight regulatory concerns in respect to AGL and the broader utility sector, and note the considerable press interest that AGL's long-flagged closure of the NSW Liddell coal power station recently attracted. These factors, together with the potential for the Victorian Government to in part regulate retail power prices, are at this stage capping our holding size in AGL.

Despite this, the structure of the industry continues to look positive for AGL. In particular, all roads continue to point toward a period in which electricity generation prices continue to remain elevated versus recent periods. Prices for baseload electricity around \$80 per megawatt hour appear sustainable into the future. In this climate, AGL will continue to exercise its balance sheet flexibility to pursue investment in various gas peaking plants, wind farms, WA expansion and potentially capital management.

#### **Key disposals and material adjustments**

| Sold                            |
|---------------------------------|
| Coca-Cola Amatil (CCL)          |
| Ainsworth Game Technology (AGI) |
| Orora Holdings (ORA)            |

Having added Consumer Staples company Wesfarmers to the portfolio, we decided to exit our underperforming position in **Coca-Cola Amatil (CCL)** in August. As we discussed in a prior report, a public contract loss and speculation of supermarket ranging issues recently weighed on CCL shares. Firstly, CCL has lost its small but noteworthy contract to supply Domino's Pizzas to competitor Asahi (Pepsi and Schweppes brands). Secondly, it appears that Woolworths has at this stage elected not to stock CCL's new 'Coca-Cola No Sugar' product. Further, speculation persists that Woolworths is limiting shelf space of branded water products, including CCL's Mount Franklin mineral water products. In the short term, such outcomes will reduce CCL's ability to drive volumes via its 'stills' (non-CSD products) and delay the re-balancing of its business. Reflecting these concerns, we elected to sell our CCL position.

**Ainsworth Game Technology (AGI)** – AGI shares have continued to rally, reflecting investors' conviction that the turnaround of the business is gaining traction, creating an opportunity for us to take profits in this name. Industry feedback continues to suggest that AGI's latest game offerings are gaining share in the key US market. In Australia, AGI's market share has likely bottomed and if the increase in current research and development spend flows through to a more competitive panel of games as we expect, then AGI is likely to win back some lost share in this market. Subsequent to our exit from the stock, AGI's FY17 results met the company's guidance, adjusting for material currency impacts and a lower tax rate. Composition of unit sales by region was quite different to our expectations and cash flow was mixed, suggesting an overall low quality result. Going forward, it appears that the US business has begun to gain some sales momentum, although our view remains that is being largely reflected in the share price. We will continue to monitor AGI with a view to revisit this name.

**Orora Holdings (ORA)** - lastly, we sold our position in ORA. This is a very well-run company that, since the demerger from Amcor, has executed on its business model in a near faultless manner. With the share price having performed well in recent times, we felt the stock reflected fair value and sold down our position. Given the quality of management, we would look to revisit ORA at a future date should the share price appear attractive, particularly if ORA is able to demonstrate potential to grow its US operations in a profitable manner.

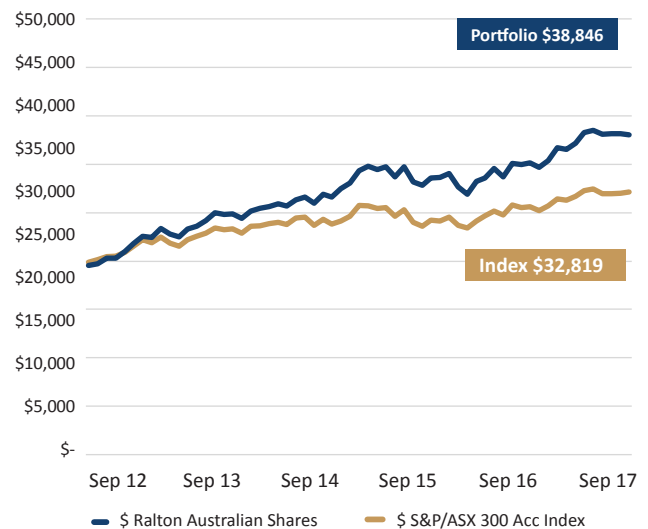
### Sector allocation

| GICS sector                | Ralton        | Index         | +/-         |
|----------------------------|---------------|---------------|-------------|
| Energy                     | 9.1%          | 4.4%          | 4.7%        |
| Consumer Discretionary     | 8.8%          | 5.0%          | 3.7%        |
| Consumer Staples           | 9.9%          | 7.2%          | 2.7%        |
| Information Technology     | 4.0%          | 1.6%          | 2.4%        |
| Materials                  | 17.6%         | 16.9%         | 0.7%        |
| Telecommunication Services | 2.8%          | 3.1%          | -0.2%       |
| Utilities                  | 1.8%          | 2.1%          | -0.4%       |
| Real Estate                | 7.7%          | 8.4%          | -0.7%       |
| Health Care                | 5.3%          | 7.0%          | -1.7%       |
| Industrials                | 4.3%          | 7.5%          | -3.2%       |
| Financials                 | 28.7%         | 36.7%         | -8.0%       |
| <b>Total</b>               | <b>100.0%</b> | <b>100.0%</b> | <b>0.0%</b> |

### Top 10 holdings<sup>#</sup>

| Company name                    | ASX code |
|---------------------------------|----------|
| Westpac Banking Corp            | WBC      |
| BHP Billiton Limited            | BHP      |
| ANZ Banking Group Limited       | ANZ      |
| National Australia Bank Limited | NAB      |
| Woolworths Limited              | WOW      |
| Aristocrat Leisure Limited      | ALL      |
| Computershare Ltd               | CPU      |
| QBE Insurance Group Limited     | QBE      |
| Boral Limited                   | BLD      |
| Commonwealth Bank of Australia  | CBA      |

### Performance comparison of \$20,000\*



**CONTACT COPIA**

1800 442 129 | [clientservices@copiapartners.com.au](mailto:clientservices@copiapartners.com.au) | [copiapartners.com.au](http://copiapartners.com.au)



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

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 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.

This document is for general information only and does not take into account the specific investment objectives, financial situation or particular needs of any specific reader. As such, before acting on any information contained in this document, readers should consider whether the information is suitable for their needs. This may involve seeking advice from a qualified financial adviser. Ralton Asset Management (AFSL 298210, ABN 45 114 924 382) (Ralton) is the provider of the Ralton Wholesale Australian Shares Model Portfolio. To subscribe, contact Copia Investment Partners Ltd (AFSL 229316, ABN 22 092 872 056) (Copia) by calling 1800 442 129 or email [clientservices@copiapartners.com.au](mailto:clientservices@copiapartners.com.au). Any opinions or recommendations contained in this document are subject to change without notice. Ralton and Copia are under no obligation to update or keep information contained in this document current.