PERENNIAL GROWTH MANAGEMENT

Perennial Socially Responsive Shares Trust

Monthly Report
31 August 2015

	Month	Quarter	FYTD	1 year	2 years	3 years	5 years
	%	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Socially Responsive Shares Trust*	-6.9	-6.8	-1.6	-1.9	6.9	12.1	8.4
S&P/ASX 300 Accumulation Index	-7.7	-8.8	-3.7	-3.2	5.1	10.9	7.9
Value Added (Detracted)	**0.8**	**2.0**	**2.1**	**1.3**	**1.8**	**1.2**	**0.5**
Net Performance	-7.0	-7.1	-1.9	-3.0	5.8	11.0	7.3

* Gross Performance. Past performance is not a reliable indicator of future performance.

Perennial Socially Responsive Shares Trust

The Trust aims to provide a total return (after fees) that exceeds the S&P/ASX 300 Accumulation Index measured on a rolling three-year basis, by investing in a selection of listed companies which also embrace and engender social performance in their corporate culture.

Portfolio manager:
Lee Mickelburough

Risk profile:
High

Trust FUM (as at 31 August 2015):
AUD4.0 million

Income distribution frequency:
Half yearly

Team FUM (as at 31 August 2015):
AUD2.4 billion

Minimum initial investment:
$25,000

Trust inception date:
December 2001

APIR code:
IOF0117AU

- **The Trust outperformed the Index in August.**
- **August reporting season highlighted the weak outlook, with many companies expecting the deterioration of their business conditions to continue.**
- **We believe it is time to invest for growth.**

Trust performance overview

The Perennial Socially Responsible Shares Trust (the Trust) outperformed the S&P/ASX300 Accumulation Index (the Index) by 0.8% in August, finishing down 6.9% against the Index which fell 7.7% for the month.

Instability in the Chinese economy and equity markets weighed heavily on global markets in August. Of the Australian market segments, only Utilities (down 0.5%) were anywhere near yielding a positive result for the period. Consumer staples (down 4.1%), Industrials (down 4.6%) REITS (down 4.0%) and Materials (down 5.1%) experienced a challenging reporting season while Telco's (down 8.3%) and Financials (down 9.6%) bore the brunt of the markets selling. Energy (down 13.3%) was the worst performing sector as oil declined to the lowest levels this year.

Reporting season highlights

The August reporting season gave some valuable insights. On a broad market view, the most apparent read through was the weak outlook and guidance delivered, with many companies, especially those exposed to mining and minerals, expecting the deterioration of their business conditions to continue. On the back of the generally downbeat assessments of the future, FY16 consensus earnings growth for the market fell from -0.7% to -1.9% (Source: IBES).

We also noted that companies are now facing the prospect of having to increase capital expenditure to maintain their current market share and create future growth. Two such examples include Brambles and Telstra. In the case of Brambles, they now expect capital invested to grow at a faster rate than their original 5% target and are guiding to US$1.5b in growth capex from FY16-19 (mostly in pallets) in the hope of stimulating growth and improving returns. The main area of focus is the US pallets business where damage rates on an ageing pool continue to climb, whilst group return on capital was down 0.6% to 15.7% in FY15, with management guiding to another slight reduction in FY16 which is an area of concern. In the case of Telstra, they have signalled their intentions to invest through extending their mobile network to stave off competition as their competitor's progression begins to erode their market dominance. Further, in the process of expanding its revenue base, Telstra has flagged offshore expansion into Asia.

The challenges that these companies face with investing back into their businesses was highlighted in the Woolworths result. Following successive quarters in FY14 and FY15 when Woolworths denied there was a price issue in Australian Food & Liquor the company has now started to invest in price. The over A$200m price investment in 4Q15 can be annualised at ~A$900m (A$225m, as mentioned on the call) yet it was noted that further investment may be required. Further, Woolworth's investment into the home improvement market The Home Improvement division at Woolworths has generated persistent losses, with accumulated losses to the end of FY15 of ~A$630m and over A$1bn in accumulated losses forecast to the end of FY18, based on our current forecasts.

Investment Themes and Stock Performance

Companies which possess strong fundamentals for growth will continue to outperform.

Spotless Group (new position) was added to the portfolio in August. Spotless has undergone a significant turnaround in the last three years, after approximately two years under private equity ownership and 12 months back on the ASX under a management team led by Bruce Dixon. The business has been restructured with unprofitable contracts exited, and management focusing on two key divisions, facilities services and laundries. Spotless has built a market leading position in the facilities services industry, with key contract wins in the Health, Education and Government sectors. Following the release of the FY15 result, Pacific Equity Partners remaining 19% shareholding was released from escrow and sold which provided the liquidity event to add Spotless to the portfolio at a price of $1.80 per share. Based on our estimates, we forecast to have a steady growth profile over the next three years (management guidance is for FY16 to materially exceed FY15 results), solid and improving ROIC and greater than 25% valuation upside.

Bluescope Steel (overweight, up 18.7%) continued recent outperformance as the company articulated their strategy to either successfully work with stakeholders to achieve an A$200m cost out program or close Port Kembla. While the exact cost of the remediation of Port Kembla is not known, should it be deemed economically viable the potential benefit to the company would be the ceasing of loss making steel production. We feel that the range of options that management has at its disposal gives them the ability to pursue improvements to profitability in the business and as such we added to our position this month.

Challenger (overweight, up 1.9%) performed strongly during the month due to its solid FY15 profit result and accompanying growth outlook. Returns are set to rise with the inclusion of its annuity products on major platforms coupled with the release of a revamped product aimed at aged care recipients. Also positively surprising was the level of dividends and, importantly, a return to 100% franking. In a world challenged for growth, we believe Challenger's solid outlook will continue to provide strong returns relative to the market going forward.

Macquarie Atlas (overweight, flat) outperformed the falling market, with its share price closing unchanged for the month. The key driver of the share price was the weak Australian dollar, which fell by 4.5% against the Euro during August and which has now fallen by more than 10% since March. Macquarie Atlas has defensive earnings from relatively mature toll road assets in France. Despite the asset's maturity, it is still expected to produce solid earnings growth which will be boosted by reduced funding costs. At its half year result this month, the company reconfirmed distribution guidance of 16c per shares (cps) for FY15, and provided first time guidance of 18cps (up 13%) for FY16. We believe that this distribution guidance is conservative given growing cash balances at the corporate level and the Australian dollar trending lower. We continue to believe that Macquarie Atlas offers the most valuation upside in the infrastructure sector.

Veda (overweight, down 14.7%) reported a result in-line with the markets expectations with NPAT up strongly to 13.8%, however as was the case in many businesses this reporting season guidance for FY16 underwhelmed the market. NPAT growth guidance was projected to be 'somewhat below' low double digit EBITDA growth as management continues to invest in Comprehensive Credit Reporting (CCR). CCR is forecast to generate a strong uplift in earnings over the short to medium term and investors are closely monitoring the point when revenue and earnings start to flow from the investment in structural reforms around comprehensive reporting.

ANZ Banking Group Limited (overweight, down 14.5%) and **Commonwealth Bank of Australia (underweight, down 11.4%)** added to their capital bases in August ahead of APRA's increased mortgage risk weights which are due to implement in July 2016. ANZ conducted a $2.5bn primary placement and CBA a 1-for-23 renounceable entitlement offer for $5.1bn. While much of the markets interpretation of the banks raising was lost in the noise of the broader market volatility, we have viewed the capital raisings as a net positive and combined with measures to de-risk investor lending we take the moves as supportive of our overweight position in the sector.

Chinese economic data has remained underwhelming and policy response is demonstrating concern.

The Chinese leadership face the reality of balancing long term reforms on corruption, the environment and market liberalisation with maintaining economic growth. There are signs that the Chinese government is becoming more aggressive in their management of the economy as they implement monetary policy to stimulate growth. In response to recent market volatility and weaker than expected economic data, the Peoples Bank of China (PBOC) dropped the one-year lending rate by 25 basis points to 4.6%, and the one-year deposit rate by 25 basis points to 1.75% in August. The Required Reserve Ratio was also reduced by 50 basis points to 18%. This was the fifth consecutive downward movement in rates this cycle.

The market's reaction to Chinese economic weakness helped to create another opportunity that we took advantage of during the month in building a new holding in **Alumina (new position, down 7.5%)**. Alumina reported a strong first half profit result which was supported by a significant increase in the fully franked interim dividend. We believe that the investment program from the last few years will place the company in a very good position to weather the current alumina price weakness. We see valuation support and strong cash flow growth driven by a continued focus on lowering costs and a change in sales mix over the next few years that will result in higher priced spot sales relative to contract sales, to Alumina's advantage.

The economic recovery in the US continues as evidenced by generally supportive economic data.

We are seeing the gradual normalisation of US monetary policy, ongoing recovery in the US dollar and general upward pressure on US interest rates. While this is now a consensus view with the market factoring in an interest rate rise before the end of the year we believe that there is still upside in select investments that have positive exposure to a rising US dollar.

Representing this theme, one of the portfolio's longest standing investments, in **James Hardie (overweight, down 7.5%)** was trimmed during August. We felt that the company's share price had run ahead of itself in the lead up to the June quarter results and we were justified in our actions as James Hardie reported results for the June quarter which revealed a significant slow-down in US fibre cement volume growth. While largely explained by soft overall market activity, volume growth is a key value and share price driver and so warrants a degree of caution. Margins, on the other hand, surprised positively due to favourable movements in raw material costs. We continue to see James Hardie as a core way to play the US economic recovery.

The portfolio exited its remaining position in **CSL Limited (exited)** during a period of share price strength early in August. As we expected, CSL issued subdued outlook statements at its result, guiding to profit growth of just 5% for FY16. This is the lowest rate of growth for many years and is clear evidence of rising competition in the global plasma products industry. We chose to exit CSL Limited on this basis as we feel the company based risks outweigh the exposure that is gained to the rising US dollar.

We believe it is time to invest for growth.

We believe that this theme is contrarian relative to current market sentiment. Where most segments of the market are still focussed on capital management, we are looking for opportunities to invest in companies that are investing capital to sustainably grow their businesses.

Encompassing this theme, we established a position in **Healthscope (new position)** leading into the company's full year result. We are attracted to Healthscope's position as one of two dominant players in the private hospital industry, leaving it well-placed to benefit from strong demand for private health services as the population ages. Healthscope will continue to invest to grow at above-industry rates for an extended period from 2017 as brownfield expansions which are currently under construction come on stream. On a relative basis, we believe the stock offers better medium term growth prospects than Ramsay Healthcare at a more attractive valuation.

One of our other investments under this theme, **Asciano (overweight, up 4.4%)** outperformed in August after entering a scheme implementation deed with Brookfield Infrastructure following receipt of a final A$9.15 bid. All Asciano directors unanimously recommended the transaction. We believe that the deal will likely go through and will hold our position through the process. On the basis that the deal completes by mid-December, we forecast our investment to earn a net return of over 7.5% excluding the potential franking estimated at $0.386. Asciano is currently seeking approval from the Australian Tax Office on franking the dividend.

Oil has entered a period of structural supply/demand imbalance in favour of supply.

Given the significant fall in oil prices most energy names significantly underperformed the index, impacting the two names we own, **Karoon Gas Australia (overweight, down 17.7%)** and **Sundance Energy Australia (overweight, down 29.0%)**. In the case of Karoon, we would highlight the company's strong balance sheet with current cash backing of approximately A$2.20 per share compared to its latest share price of $1.90 and with minimal drilling commitments reinforcing the company's very strong position. In the case of Sundance Energy Australia we believe that current forward spending commitments are minimal and can either be met from operating cash generation or deferred. We also believe that Sundance is in a good position to grow its business through acquisition in the event that oil prices remain low and other shale peers are forced to divest assets at distressed values.

In regards to the importance of balance sheet strength, **Santos (not held, down 28.7%)** announced that the current CEO, David Knox, will step down once a successor has been appointed. In the interim, Chairman Peter Coates will become Executive Chairman and conduct a strategic review of the company. We believe that these decisions are a direct consequence of the company's weak balance sheet after failing to raise equity when the share price was significantly higher. A strategic review was announced in their FY15 results in which it is likely a combination of both asset sales and an equity raise will be considered. We remain cautious that whatever solution is reached that it is likely to be dilutive for existing shareholders.

In the oil and gas space, **Origin (not owned, down 17.4%)** was a positive contributor to performance as the company announced a A$550m capex increase for its APLNG project from guidance provided at its half year results in February and the falling oil price saw investors focus turn to the leveraged balance sheet position.

During the month we initiated a position in **Contact Energy (new position)** after Origin sold down its entire interest and Contact announced that it is pursuing an ASX listing. We believe that at the sell down price Contact showed strong valuation upside of approximately 24% and we still see approximately 12% upside after the stock rallied significantly over the month. We believe that following a significant period of investment over the last few years, cash flow should grow at around 10% per annum over the next few years. We also believe that generation costs will be reduced as more generation will come from low cost renewable sources and that the company's cost management program will see its cost to serve its customers fall approximately 11% from FY15 levels.

At the end of the month the portfolio held 40 stocks and had effective cash of 1.1%.

Market Overview

Roiled by the events unfolding in China, the Australian market (S&P/ASX 300 Accumulation Index) fell 7.8% in August. European markets fell with the CAC 40 down 8.5%, the Eurostoxx 50 down 9.1% and the DAX down 9.3%. US markets performed a little better with the S&P 500 Index down 6.0%, the Dow Jones down 6.2% and the NASDAQ down 6.7%. Of note in the US, the CBOE Volatility Index (VIX), or the fear index as it is commonly known, spiked to its highest levels since the financial crisis in late August, indicating very high levels of fear among market participants. At one point, the 5-day rate of change in the VIX was the highest ever recorded. Accompanying the volatility, the US experienced its largest ever intra-day drop of 1089.42 points. As would be expected, Chinese markets performed poorly as the local indices continued their pull back from their bull market highs with the CSI 300 falling 11.7% and the Hang Seng falling 11.8%. No major market in the region was spared with the Nikkei 225 down 8.2%.

With the Greek exit saga behind it, the market turned its focus to China and the country's ambitious attempt to shore up domestic equity markets after sharp falls from its mid-June peak. The first move by Chinese authorities was to devalue the currency mid-month by 3%. This was seen more through the prism of proof that the economy was excessively weak rather than as an ongoing reform designed to open up the country's capital account and allow a greater role for markets to determine prices. While the 3% devaluation did remove some build up in the real effective exchange rate, the move to make the fixing mechanism more market based seems more about the Renminbi meeting the "freely useable" criteria for inclusion in the IMFs Special Drawing Rights (or currency weighted) basket.

Later in August, clearly concerned about the Caixin manufacturing PMI (formerly the HSBC Flash manufacturing PMI), which dropped to a final reading of 47.8 in July from 49.4 in the prior period (and lower than the 48.3 expected), the Peoples Bank of China (PBOC) lowered the one-year lending rate by 25 basis points to 4.6%, and the one-year deposit rate was adjusted down by 25 basis points to 1.75%. The Required

Reserve Ratio was also reduced by 50 basis points to 18.0%. In other economic data points, China's July CPI increased 1.6% year on year, greater than the 1.5% increase expected, while PPI deflation accelerated to -5.4%year on year against -5.0% expected. House prices declined in 36.2% of cities from June to July in the NBS 70-city house price index. M2 money supply rose to 13.3% year on year in July ahead of the 11.7% expected and up from the 11.8% in June. New loan creation totalled 1,480bn yuan in July against the 750bn yuan expected and the 1,280bn in the prior period. These loans were created to support the China Securities Finance Corporation's aggressive purchasing of stocks to stabilise the Chinese equity markets.

Along with global markets, the US experienced significant volatility including its largest intra-day drop of 1,089.42 points. The US economic data was generally positive as a preliminary reading showed the US economy expanded by 3.7% in the June quarter, ahead of the 3.2% expected and the 2.3% prior. The ISM manufacturing PMI decreased 0.8 points to 52.7, behind the 53.5 expected while the ISM non-manufacturing PMI soared 4.3 to 60.3 against the 56.2 expected. Housing starts tempered gains in July after surging 9.8% for the month in June, rising a meagre 0.2% against the 0.5% expected. Labour market conditions remained firm as the unemployment rate remained steady at 5.3% in July and nonfarm payrolls totalled 210,000 in June, very much in line with the 212,000 expected. The Federal Reserve vice chairman, Stanley Fischer, kept the door open for the US to raise interest rates for the first time in a decade after he said there was good reason to believe that inflation will move higher as the forces holding it down continue to dissipate. The lift off window remains between September and December with most FOMC participants looking for at least one tightening by year end. We would also highlight that the Federal Reserve Chairman, Janet Yellen has been at pains to point out that the upcoming Fed tightening cycle will be gradual and that until the legacies of the financial crisis have been finally worked through. The US cash rate is therefore likely to remain lower than would otherwise be the case given their longer term growth and inflation forecasts. Inflation remains under control with headline CPI for July rising 0.1% for the month, just behind the 0.2% expected.

The Australian economy continued to generate mixed readings over the month with these reflecting the diverse range of forces at work. Retail sales for June showed signs of responding to earlier rate cuts and the May Budget, rising a stronger than expected 0.7% over the month and 0.8% over the quarter in real terms. The labour market was mixed over July with job creation, and the unemployment rate, all rising more than expected.

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Of the interest rate sensitive sectors, the housing sector bounced back after new housing starts fell 8.2% in June to rise 4.2% in July ahead of the 3.0% expected. On the consumer side, the 0.7% rise in June retail trade from May was greater than the 0.4% expected while consumer sentiment also rose strongly in August, up 7.8% to a reading of 99.5. Encouragingly, the labour market held onto recent strong gains. Total employment lifted by 38,500 in July after June's revised 7,000 gain. Despite the job numbers, the unemployment rate came in at 6.3% higher than the 6.1% expected and ahead of the 6.0% prior. Conditions in the business sector reversed June's gains with the NAB business survey recording strong falls in business conditions and confidence in July, declining 5 points and 6 points respectively. The June quarter capital expenditure survey highlighted the extent of the transition the economy faces as the resources boom moves from the investment to production phase. Real private capital expenditure fell a greater than expected 4% over the June quarter and this follows on from a 4.7% fall over the previous quarter. For 2014-15, total capital expenditure was $150.6bn and this is expected to fall $35.8bn to $114.8bn over 2015-16. The decline is made up of a $22bn fall in mining, $0.7bn fall in manufacturing and $13bn fall in "other", the composition of which is not specified. The only bright spot in the survey was a lift in expectations in manufacturing and which may suggest early signs of a response to a lower currency.

The RBA left the cash rate unchanged in early August and appeared to have a neutral bias on the cash rate. In its Statement of Monetary Policy earlier in the month, the Reserve Bank of Australia (RBA) revised down its near term growth forecasts, largely reflecting a downward adjustment for the rate of population growth and the moving back the timing of a lift in non-mining investment. They expect the economy to grow by 2.5% over 2015-16 and 3% over the following year. Underlying inflation is forecast to track 2.5% over the outlook period and while they didn't expect the unemployment rate to spike as much as in the May Statement, they don't see the unemployment rate falling to below 6% until mid-2017. Given such an outlook, we expect them to leave the cash rate unchanged at 2% until mid-2017.

Spot Brent crude oil experienced a third month of declines, plummeting 17.9% in August, taking the commodities decline to nearly 22% since the end of April. Similarly, base metals experienced a fourth straight month of declines falling with the LME Index falling 2.5% in August which makes it nearly a 20% fall since the end of April. Somewhat surprisingly iron ore bucked the trend of the commodity and equity markets, rising 5.5%. Spot gold bounced back from a 6.6% fall in July to be up 3.3% in August.

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Best/Worst Performers			
(Best) company	**Month Return %**	**(Worst) company**	**Month Return %**
Bluescope Steel Limited	18.7	Wesfarmers Limited (Restricted)	-1.6
Asciano Limited	4.4	ANZ Banking Group Limited	-14.5
Challenger Limited	1.9	BHP Billiton Limited (Restricted)	-4.8
Macquarie Atlas Roads Group	0.0	Sundance Energy Australia Limited	-29.0
Fairfax Media Limited	2.9	Veda Group Limited	-14.7

New/Increased positions	
Alumina Limited	New
Spotless Group Hld Ltd	New
Telstra Corporation.	Increased
Healthscope Limited	New

Exited/Decreased positions	
CSL Limited	Exited
Mayne Pharma Ltd	Reduced
James Hardie Industries	Reduced
Seek Limited	Reduced

Top 10 Holdings		
Stock name	Trust weight %	Index weight %
Westpac Banking Corp	9.5	7.3
ANZ Banking Grp Ltd	8.4	5.7
National Aust. Bank	7.2	6.0
Commonwealth Bank.	6.6	9.4
Asciano Limited	4.6	0.6
Caltex Australia	4.1	0.6
Westfield Corp	3.7	1.4
Macquarie Group Ltd	3.7	1.9
Telstra Corporation.	3.5	5.2
Incitec Pivot	3.4	0.4

Asset Allocation		
Sector	Trust weight %	Index weight %
Energy	5.9	4.5
Materials	15.1	14.4
Industrials	13.6	7.6
Consumer Discretionary	4.4	4.6
Consumer Staples	0.0	6.9
Healthcare	5.6	6.5
Financials-x-Real Estate	44.6	38.5
Real Estate	3.7	8.2
Information Technology	0.0	1.0
Telecommunication Services	3.5	5.7
Utilities	2.5	2.3
Cash	1.1	-

Rounding accounts for small +/- from 100%.

For all other enquiries please contact us on 1300 730 032
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Signatory of:

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