PERENNIAL GROWTH MANAGEMENT

Perennial Socially Responsive Shares Trust

Quarterly Report
30 September 2014

	Quarter	FYTD	1 year	2 years	3 years	5 years
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Socially Responsive Shares Trust*	-0.5	-0.5	6.8	16.4	15.6	6.5
S&P/ASX 300 Accumulation Index	-0.6	-0.6	5.7	14.3	14.4	6.6
Value Added (Detracted)	**0.1**	**0.1**	**1.1**	**2.1**	**1.2**	**-0.1**
Net Performance	-0.8	-0.8	5.8	15.3	14.5	5.5

* 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 30 September 2014):
AUD48.8 million

Income distribution frequency:
Half yearly

Team FUM (as at 30 September 2014):
AUD2.4 billion

Minimum initial investment:
$25,000

Trust inception date:
December 2001

APIR code:
IOF0117AU

- **The strongest performing sector was healthcare.**
- **We remain attracted to CSL's above-industry growth rates, prospective R&D pipeline and strong ROIC.**
- **Major equity market indexes provided mixed returns in the September quarter.**

Trust performance overview

The Perennial Growth Socially Responsive Shares Trust (the Trust) returned -0.5% in the quarter, outperforming the S&P/ASX300 Accumulation Index (the Index) by 0.1%, with the Index returning -0.6%.

After a solid June quarter the market experienced a period of consolidation. Banks were the worst performing sector (down 4.5%) as concerns about capital requirements and early signs of the unwinding of the carry trade came into investor's focus. The strongest performing sector was healthcare (up 9.4%), helped by the sectors defensive characteristics and the Australian dollar (AUD) which declined 7.1%. Materials were weaker (down 2.8%), led by iron ore miners. The situation could have been worse for the miners, however the sector was provided some shelter by the falling dollar.

Trust performance

Contributors

Lend Lease (up 13.2%) continued its recent outperformance and added to its success in the global construction market by announcing that it has entered into a circa $5.3b Public Private Partnership (PPP) with the Victorian State Government to finance, design and construct stage one of the East West Link in Melbourne. We have taken management's confidence around the company's earnings outlook for the next three years as a positive sign and believe that their recent earnings result was conservatively stated with write downs and restructuring charges totalling about $150m impacting this year's profits. Lend Lease's strong profit outlook in FY16 and FY17 remains unchanged when returns will be realised on its development pipeline in residential apartments and the Barangaroo commercial towers.

Karoon Gas (up 13.7%) performed strongly as the market began to recognise that the company's funding position has improved significantly since the announced sale of Poseidon to Origin Energy. The pre-emption rights held by Conoco Philips and PetroChina passed without either exercising, thereby passing one of the milestones necessary for Karoon to receive the cash from the transaction, whilst management announced a buyback of up to 10% of issued capital in August. At current levels we view Karoon as undervalued with a fully funded exploration and evaluation activity phase about to commence in Brazil.

CSL (up 12.4%) reported well in the August earnings result. CSL's outlook commentary was strong, with the company guiding to 12% NPAT growth and stronger growth in EPS due to the ongoing share buybacks. We remain attracted to CSL's above-industry growth rates, prospective R&D pipeline and strong ROIC.

BHP Billiton (down 3.9%, not held) performed poorly over the quarter in line with falling commodity prices and underwhelming Chinese economic data. As the Trust does not own BHP Billiton, the companies poor performance creates a relative positive contribution when compared to the Index.

Detractors

Vocation (down 20.5%) underperformed after conducting a capital raising to increase their capacity to make acquisitions in line with their corporate strategy. Vocation updated the market on the audit of the BAWM Group one of the company's Registered Trading Organisations (RTOs) by the relevant Victorian State Government authority. After reviewing the situation thoroughly and accounting for the audit procedure and history of outcomes, we are comfortable with our holding in Vocation being added to the position in this time of weakness.

JB Hi-Fi (down 14.4%) underperformed following its FY14 result. JB Hi-Fi announced NPAT increased 10%, in line with company guidance, however like for like sales in July declined 5.5% predominately due to weakness in the tablet category. This weaker start to the year led to a relatively muted FY15 sales growth guidance which resulted in share price weakness after the result announcement. Whilst disappointed with the weaker start to the year and the sales guidance, we still see several growth drivers for JB Hi-Fi including both the JB Home appliance and the commercial businesses which complement the ongoing rollout of the core electronics store format. In FY15 we remain optimistic that the release of the iPhone6 will drive store traffic and also that JB Hi-Fi won't experience the same inventory shortage in game consoles that it experienced at Christmas last year resulting in restricted sales in this category. Based on our estimates the valuation is undemanding with greater than 25% valuation upside, supported by a strong balance and excellent cash flow generation.

WorleyParsons (down 9.1%) shares fell after a reporting season result that was at the lower end of the guidance range. Margin performance in the second half of the year was encouraging driven by an aggressive cost out program (2200 overhead positions were eliminated during the year) and strong cash generation was also a highlight. Investors were concerned by management's commentary around the flat outlook for Hydrocarbons capital expenditure which is the key driver of WorleyParson's revenues. We believe that the company is well positioned to resume earnings growth in FY15 due to a solid period of contract wins and a significantly more efficient cost structure. Worley continues to have strong cash generation and we believe the current share price undervalues the long term future of the company's globally successful business model.

Henderson (down 10.65%) reported an interim result for this current financial year showing continuing strong growth in assets under management with increasing diversity of products by investment class and region. Investors show some concern in regards to increasing costs in the period and the ongoing challenge in accurately forecasting performance fees when providing guidance. In our view these issues remain short term and we believe the result continues to show the group's development. We retain our positive outlook on the company due to its many attractive financial drivers and significant undervaluation.

Market overview

The major equity market indexes provided mixed returns in the September quarter. The North American indexes yielded positive returns with the Dow Jones climbing 1.3%, the S&P 500 up 0.6% and the Nasdaq rising 1.9%. Conversely, the FTSE 100 fell 1.8% and Euro Stoxx 50 declined 0.1%. Of note, the Nikkei experienced a very strong quarter rising 6.7%.

Geopolitical risks remained heightened for the period as anti-terrorist military action stepped up in the Middle East. In Europe tensions continued between Ukraine and Russia while student led pro-democracy rallies in Hong Kong provided investors some cause for concern towards the end of the quarter.

The European Central Bank (ECB) announced a 10 basis points reduction in interest rates in September and confirmed that purchases of asset-backed securities will commence in October after Eurozone CPI fell from 0.5% year-on-year (y/y) in June to 0.3% in September and levels of unemployment remained persistently high with tepid economic growth.

The US Federal Open Market Committee (FOMC) continued to reduce quantitative easing at a rate of $10b per month in light of stronger economic data and remained on track to conclude easing in October. 2014 GDP expanded at an impressive annual rate of 4.6% quarter-on-quarter (q/q) while Nonfarm payrolls underwhelmed and the unemployment rate remained unchanged at 6.1%. Consumer confidence, as measured by the University of Michigan survey, reached a recent high of 84.6 in September up from 82.5 in June. The ISM PMIs also showed strength as the manufacturing PMI rose from 55.3 in the June release to 59.0 in the September release and non-manufacturing PMI rose from 56.0 to 59.6. The conclusion of quantitative easing and strong data prints naturally raised speculation on the timing of interest rate hikes in the US, in response the median federal funds rate forecast of FOMC participants for 2015 increased to 1.375% from 1% in June.

Chinese GDP growth in 2Q14 came in at 7.5% y/y, slightly ahead of the 7.4% print in 1Q14 while September quarter economic data remained underwhelming. The HSBC manufacturing flash PMI came in at 50.2 in September against a reading of 50.7 in June. M2 money supply growth eased to 12.8% year on year. New loan creation declined from 1079bn Yuan in June to 702.5b Yuan in August as the downward calendar year trend remained intact and fixed asset investment growth slipped to 16.5% y/y in August down from 17.3% in June.

The Reserve Bank of Australia (RBA) left the cash rate unchanged at 2.5% over the September quarter reaffirming its view of a "period of stability" in interest rates. The greatest change in the RBA's commentary came in the September minutes as it was revealed that the RBA is becoming more concerned about risks of overheating in the property sector. Economic data peaked in July before falling away in the end of the quarter. NAB business confidence decreased 3 points to 8 points in August while the NAB business conditions index halved to 4 points and the Westpac MI consumer confidence index slumped in September 4.6%. Jobs data provided the largest surprise as the economy apparently gained 121,000 jobs in August; the largest monthly gain on record. Unfortunately this result appears to be significantly impacted by a recent change in the reporting panel and an increase in the participation rate. Evidence of the statistical discrepancy may be identified when comparing the apparently strong jobs growth to the meagre increase in aggregate monthly hours worked which grew by the smallest measurable increment of 0.1 million hours. Building approvals for July rose 2.5% month-on-month (m/m).

Commodity prices experienced significant declines as supply increased strongly over demand. Spot Brent Crude fell 16.9% over the quarter, its largest decline since 2Q12, as Libyan ports resumed exports and North American production increased. The benchmark Tianjin 62% Spot Iron ore contract plummeted 17.4% as low cost producers continued to ramp up supply in the face of slowing Chinese demand. In other metals, copper fell 4.6%, lead up 2.5%, tin up 10% and nickel up 14.4%. There was no shine on gold either as it fell 9% over the period.

Environmental, Social and Governance (ESG)

One topic that has got considerable press coverage over the past quarter is the push by a number of investor groups to pressure funds to reduce or exclude investments in fossil fuels. This is an interesting development and follows studies earlier in the year that addressed the concept of "stranded carbon assets" - effectively fossil fuels that may be rendered uneconomic by the world shifting its energy reliance toward renewable energy and lower carbon energy such as nuclear. We have spent considerable time analysing these concepts and investigating the impact they will have on our investment process. We feel it is important to be prepared for this potential eventuation in managing our portfolio exposures. Over time, it is our opinion that coal's position as the main fuel for electricity generation will decline as renewables become more cost effective and lower carbon fuels become more efficient to use. The rise of shale gas in the US is an example of such a shift and given that gas releases up to 50% less CO2 per MWh of electricity produced this trend will be supported by the price of carbon in some countries. We see gas as a longer term "transition fuel" and consequently feel the need to be positioned well for these changes over the next decade.

The concept of a "fossil fuel free" portfolio is interesting in theory but the reality is considerably more complex. There are very few Australian listed companies that would escape exclusion if strict criteria were applied. And if criteria were relaxed, the reference to "fossil fuel" loses impact. We take this aspect of investing very seriously and closely study future trends and developments but they also must reflect the outcomes sought by our stakeholders.

Top 10 Holdings

Stock name	Trust weight %	Index weight %
Commonwealth Bank.	7.1	9.1
National Aust. Bank	7.0	5.7
ANZ Banking Grp Ltd	7.0	6.3
Westpac Banking Corp	5.7	7.4
CSL Limited	4.9	2.6
QBE Insurance Group	3.6	1.2
Westfield Corp	2.8	1.1
Santos Ltd	2.7	1.0
Aurizon Holdings Ltd	2.5	0.7
Goodman Group	2.4	0.6

Asset Allocation

Sector	Trust weight %	Index weight %
Energy	9.1	6.4
Materials	10.2	16.4
Industrials	9.6	7.1
Consumer Discretionary	2.6	4.2
Consumer Staples	0.8	7.9
Healthcare	12.4	5.1
Financials-x-Real Estate	38.6	37.4
Real Estate	7.6	7.2
Information Technology	0.9	1.0
Telecommunication Services	2.0	5.5
Utilities	2.7	1.8
Cash	3.5	-

Rounding accounts for small +/- from 100%.

For all other enquiries please contact us on 1300 730 032 or visit www.perennial.net.au.

Signatory of:

PRI Principles for Responsible Investment