PERENNIAL GROWTH MANAGEMENT

Perennial Socially Responsive Shares Trust

Quarterly Report
30 June 2014

	Quarter	FYTD	1 year	2 years	3 years	5 years
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Socially Responsive Shares Trust*	2.6	22.7	22.7	21.5	11.0	10.9
S&P/ASX 300 Accumulation Index	0.9	17.2	17.2	19.5	9.9	10.9
Value Added (Detracted)	**1.7**	**5.5**	**5.5**	**2.0**	**1.1**	**0.0**
Net Performance	2.4	21.5	21.5	20.4	10.0	9.9

* 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 June 2014):
AUD49.0 million

Income distribution frequency:
Half yearly

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

Minimum initial investment:
$25,000

Trust inception date:
December 2001

APIR code:
IOF0117AU

- **Australian equity markets had a positive quarter, consolidating on the positive returns in the March quarter.**
- **Resmed, Worley Parsons and Lend Lease Group all contributed positively to the Trust's performance.**
- **Regional equity markets were all stronger in the quarter.**

Trust performance overview

The Perennial Growth Socially Responsive Shares Trust (The Trust) closed up 2.6% in the quarter, strongly outperforming the S&P/ASX300 Accumulation Index (the Index) by 1.7%, with the Index closing up 0.9%.

The top contributor during the quarter was Resmed Inc. (up 15.9%) as the stock rallied strongly following the release of its Q3 result in April, the highlights of which were accelerating revenue growth and solid EPS growth of 9%. As foreshadowed in last quarter's report, Resmed has reviewed pricing across its US product offering which resulted in market share and revenue recovery, albeit at the expense of margin. Importantly the growth outlook for FY15 and beyond is improving as there will be multiple product launches across masks, flow generators and respiratory products. We continue to believe that Resmed's high ROIC, growth profile and leading technology position are undervalued at the current share price.

Worley Parsons Ltd (up 15.0%) announced two important contracts during the quarter: Phase 2 (upstream) for the QCLNG project in Gladstone and an extension of a major Brazilian Iron Ore upgrade for Vale. The key reason for the share price strength however was that the company got through to the end of the financial year without revising its outlook after profit downgrades in May and November last year. This validated our view that the November 2013 downgrade was largely attributable to non-recurring items (notably a problem fabrication contract in Canada and staff restructuring costs). We have reduced our position at higher levels but continue to hold the stock in the portfolio. We believe the stock is undervalued and is exposed to attractive international oil and gas and North American capital expenditure cycles and now has a renewed focus on cost discipline.

Lend Lease Group (up 10.6%) performed strongly during the quarter driven by the dual themes of Australian infrastructure investment and the residential property upswing. Lend Lease has substantial exposure to both cycles. In addition the company held an investor day at Barangaroo in Sydney earlier in the quarter, where the development is progressing well post the fire late last quarter. We were impressed by the scale and design of the project and also the positive news that construction of the third office tower will commence following leasing deals with KPMG and HSBC. The investor day also highlighted Capella Capital, Lend Lease's in-house finance division that arranges complex construction and financing bids on Public Private Partnerships (PPP) projects and has been instrumental in the company's success in this field.

The Trust's holding in Challenger Limited (up 16.3%) also added value. Challenger provided a business update to the market where management discussed several long terms trends which it expects to drive future earnings growth.

The Trust's biggest detractor from performance was Qrxpharma Ltd (down 86.6%). While the portfolio's holding in drug development company Qrxpharma is relatively small, the sharp fall in its share price during the early part of the quarter was costly. The company announced that its promising pain treatment drug, Moxduo had been knocked back by the US Food and Drug Administration (FDA). While the company still wished to pursue licencing in the US, trials are both costly and time consuming. This is a very disappointing outcome considering our recent purchase of the stock in a capital raising. Management were particularly confident of a positive ruling by the FDA advisory committee and had considerable data backing up that confidence. We elected to exit the position following this significant negative news.

Also detracting from performance was QBE Insurance Group (down 15.2%). The only relevant announcement from the company was the reaffirmation of its strategic review of the US middle market business. The new leadership in the US is proving to be unsettling for those concerned about the very short term; however, we are confident that the business and the reviews being undertaken are pursuing a more sustainable footing for the medium to longer term business. The other area of market concern to highlight was the initial public offering of Genworth's Lender Mortgage Insurance (LMI) business in Australia. The only other material player in the Australian market is QBE and this transaction helps us understand the look through valuation we would ascribe to this business. It is also highlighting some of the current challenges inherent in the industry, including regulatory risks and the concentrated nature of the client base. Finally, the strength in US treasuries with the current federal fund rate materially below neutral levels poses a short term risk to the earnings for QBE as they discount future claims liabilities and report the changes in the profit and loss statement. As this driver normalises the earnings are expected to rise materially.

Mayne Pharma Ltd (down 10.0%) also detracted from performance. After a terrific March quarter where the stock added close to 20%, Mayne Pharma retraced some of those gains. With its strong pipeline of new drug releases and product development, we remain very confident about the company's growth prospects over the next few years. Mayne Pharma has a strong management team, excellent production facilities and an improving distribution network in the US. Most importantly, the company still has plenty of valuation upside. During the quarter the company announced it had completed the out-licensing of its SUBA Itraconzaole intellectual property (IP) to US-based HedgePath Pharmaceuticals, Inc which will see it work on clinical development, registration and commercialisation of patented oral formulation of SUBA for the treatment of a variety of cancers in the US.

Mermaid Marine (down 12.7%) also detracted from performance. During the last quarter Mermaid announced the acquisition of the assets of Jaya Holdings. This was transformational for the group and important as the local market conditions begin to moderate. The market continued to absorb this transaction and by quarter end seems to now have a reasonable handle on the opportunity it presents following a number of presentations by the company. The focus then turned to the conditions in the local market and the prospect of the company missing is profit guidance. Despite the forecasts being reaffirmed as recently as last month the stock is yet to recover to the levels reached last quarter. More recently the concern has turned to the potential for ongoing industrial action for both the seaside and the onshore workers. These are challenges that have arisen in the past and have proved to be costly for a short period of time. Beyond these challenges we see material upside as the benefits from the acquisition and stability in local activity levels emerge over the coming year.

Market overview

After the market's strong March quarter (up 2.0%), it was pleasing to see consolidation with another rise in the June quarter. A falling iron ore price and a rising Australian dollar (AUD) were a drag on the materials sector (down 3.1%), while a rally in global bond markets (fall in yield) helped defensive yield sectors such as property (up 9.2%) and utilities (up 7.3%). Strength in the oil price underpinned the energy sector which also outperformed (up 5.1%).

Regional equity markets were all stronger in the quarter with the UK's FTSE100 up 2.2%, the US S&P500 up 4.7%, Japan's Nikkei up 2.3% and the Euro Stoxx 50 up 2.1%.

Earlier in the quarter there were emerging concerns of a slowdown in China, along with escalating political and military tension between Russia and the Ukraine but offset by continued signs of economic improvement in Europe and weather related disruption in the US easing.

Globally, the European Central Bank (ECB) cut interest rates late in the quarter and introduced new liquidity measures for banks designed to fend off the threat of deflation, and in China manufacturing data showed improvement. US economic data was mixed towards the end of the quarter with the FOMC's 2014 GDP forecasts revised down to 2.2% and retail sales (up 0.3%) below expectations, while non-farm payrolls came in above expectations at 499,000 for April and May combined.

The US Federal Open Market Committee (FOMC) continues to reduce quantitative easing, with its monthly asset purchases proposed for April falling by $10 billion to $45 billion per month and in the June meeting announced a further reduction by $10 billion to $35 billion. The US Fed Chair Janet Yellen noted that there was no rush to withdraw monetary policy support for the economy.

The European economy continues to offer a tepid rate of recovery with the unemployment rate for the region falling slightly to 11.8%, and both manufacturing and services PMI's for May remaining in expansionary territory, coming in at 52.5 and 53.5 respectively. In June the European Central Bank (ECB) cut interest rates and introduced new liquidity measures for banks designed to fend off the threat of deflation.

There were tentative signs of improvement in the Chinese economy, with the HSBC manufacturing flash PMI increasing in June to 50.8, rising above the key 50 level for the first time since December 2013. Both imports and exports over the quarter came in ahead of consensus forecasts. Weaker fixed asset investment and a slower rate of industrial production growth highlighted the challenges faced by the Chinese leadership in maintaining economic momentum.

Domestically, in May the first budget delivered by Treasurer Joe Hockey was a tough one which saw the announcement of a number of spending cuts and tax increases as the government battles a widening budget deficit. Scaremongering ahead of the Budget and poor articulation of the Budget's laudable medium term direction led to a severe decline in consumer sentiment. The risk is that a negative feedback loop develops between falling levels of confidence and the real economy. This lead to weaker economic data in June with the Westpac Consumer Confidence Index rising only 0.2% following a 7% fall in the previous month, May building approvals fell 5.6% with revisions down for March and April, and retail sales rose 0.2% which was below expectations. In more positive news GDP posted its strongest quarterly gain since 1Q12, rising 1.1%. The Australian Dollar (AUD) saw solid gains against the USD rising 1.8% to 0.9395 following the comments from Fed Chair Yellen which drove a rise in the

carry trade despite weaker domestic economic fundamentals and soft commodity markets in recent months.

Commodity performance was mixed with ongoing concerns around the economic outlook for China resulting in the iron ore spot price hitting a 20 months low of $89 before recovering to close the quarter at $93.80 (down 19.7%). The price of oil (Brent +4.3% / WTI +3.7%) rose as concerns increased that the conflict in Iraq could disrupt global supply, whilst in base metals nickel (up 19.0%), zinc (up 10.2%) and copper (up 4.5%) were all stronger. The gold spot price rose (up 3.4%).

Environmental, Social and Governance (ESG)

If you think that environmental policy under the current government is confusing, you're right. The scrapping of the carbon tax was largely expected and because of that, there has been little investment based on it and there will be little impact on the consumer, company profits or the energy industry (despite the political rhetoric). However, more important to real investment and the future of the energy industry in this country is the outlook for the Renewable Energy Target (RET). The last minute tango between the Palmer United Party (PUP) and the federal government in getting the carbon tax excised meant that the RET may well remain largely intact – something that was not expected. This is significant. The RET has been in place for over a decade and its existence has helped build a vibrant and innovative renewables industry that has many hundreds of millions invested and is a significant employer (not to mention reduces carbon emissions). Until recent times it has had the support of the energy industry and both sides of politics.

This changed last year when Origin Energy CEO Grant King publically questioned the target as not realistic (20% renewable by 2020 was the original target) given falling demand. Behind this was a combination of the reality that targets made five years ago on usage are no longer reachable and the fact that Origin had underinvested in renewable energy (and wrongly backed geothermal energy as its favoured source) and would struggle to meet targets. What started as a move to reduce the target (and even we had misgivings about it being attainable in the current form) ended up being grasped by certain industry lobby groups and parts of the political spectrum and looked like the RET was at risk of greater emaciation. Step up Clive Palmer. In his negotiations over the carbon tax, it looks like the trade-off was the retention of the RET – at least for the term of this government. While there may be some changes such as exemptions for the aluminium industry (as if that industry doesn't get enough assistance from taxpayers), we feel that there is now a much improved chance of its retention. We believe that the RET has made a significant contribution to a growing industry. From large scale renewable projects to rooftop solar photovoltaic systems, it has given certainty to investors, operators and the electricity industry generally and most importantly, reduced thermal electricity reliance and carbon emissions.

Top 10 Holdings

Stock name	Trust weight %	Index weight %
ANZ Banking Grp Ltd	8.3	6.7
Commonwealth Bank.	7.6	9.7
Westpac Banking Corp	6.8	7.8
National Aust. Bank	5.9	5.7
CSL Limited	4.6	2.3
Lend Lease Group	3.4	0.5
ResMed Inc.	3.2	0.3
Santos Ltd	2.8	1.0
QBE Insurance Group	2.8	1.0
Transurban Group	2.7	1.0

Asset Allocation

Sector	Trust weight %	Index weight %
Energy	10.8	6.3
Materials	7.4	16.9
Industrials	11.6	6.9
Consumer Discretionary	2.6	4.2
Consumer Staples	0.7	7.9
Healthcare	10.0	4.6
Financials-x-Real Estate	41.0	38.2
Real Estate	5.8	7.1
Information Technology	0.7	0.8
Telecommunication Services	3.6	5.2
Utilities	2.3	1.8
Cash	3.3	-

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:

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