PERENNIAL GROWTH MANAGEMENT

Perennial Socially Responsive Shares Trust

Quarterly Report
31 December 2014

	Quarter	FYTD	1 year	2 years	3 years	5 years
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Socially Responsive Shares Trust*	0.2	-0.4	4.5	13.4	15.3	5.9
S&P/ASX 300 Accumulation Index	2.9	2.4	5.3	12.3	14.7	6.5
Value Added (Detracted)	**-2.7**	**-2.8**	**-0.8**	**1.1**	**0.6**	**-0.6**
Net Performance	-0.1	-0.9	3.5	12.3	14.3	4.9

* 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 31 December 2014):
AUD48.8 million

Income distribution frequency:
Half yearly

Team FUM (as at 31 December 2014):
AUD2.4 billion

Minimum initial investment:
$25,000

Trust inception date:
December 2001

APIR code:
IOF0117AU

- **After a period of consolidation, the equity market went on a wild ride in the December quarter.**
- **Top contributors to the Trust's performance included BHP Billiton (not held), Woolworths (not held) and Westfield Corporation.**
- **Companies which possess strong fundamentals for growth will continue to outperform.**

Trust performance overview

The Perennial Socially Responsive Shares Trust (The Trust) closed up 0.2% in the quarter, underperforming the S&P/ASX300 Accumulation Index (the Index) by 2.7%, with the Index closing up 2.9%.

After a period of consolidation, the equity market went on a wild ride in the December quarter. The market came close to testing 2014 lows twice before finishing strongly in the "Santa Rally" leading up to Christmas. Healthcare was the strongest performing sector, rising 13.9%, helped by its significant offshore earnings as the Australian dollar plummeted 6.7%. Classically defensive sectors with high yields also performed well, with Telecommunications and A-REITs yielding double digit returns. Energy was the worst performing sector falling 17.8% while materials also performed poorly, falling 5.8%. The situation could have been worse for the Australian miners, however the sector was provided some shelter by the falling dollar.

Quarterly Investment Themes and Stock Performance

Top contributors to the Trust's performance included BHP Billiton (not held), Woolworths (not held), Westfield Corporation, CSL, Origin Energy (not held), and Woodside Petroleum (not held). Top detractors included Vocation, Santos, Karoon Gas, Sundance, Worley Parsons, and Mermaid Marine.

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

We continue to hold Brambles (up 11.7%) in our portfolio as it continues its path of global growth through superior provision of supply chain logistics predominately via its CHEP and IFCO branded products and associated services. The divestment of Recall in December 2013 has allowed Brambles to focus on the higher returning and growth segments of the business. Brambles has a high quality management team, a strong growth outlook (guidance is for FY15 underlying profit growth of 7-10%), greater than 12% valuation upside and is leveraged to a weaker Australian dollar with less than 15% of earnings coming out of Australia.

As well as possessing solid fundamentals, CSL (up 16.9%) is also clearly a beneficiary of the weaker Australian dollar. CSL held its annual Research and Development (R&D) Investor Day during the quarter, which pointed to a number of exciting near term products that could add materially to profit. For example, the first of CSL's three recombinant clotting product therapies (Factor IX) will be launched next financial year. Factor VIII will follow in FY17, and a subcutaneous delivery of Berinert could expand the market opportunity in that segment also. Longer term, the trial for a heart protecting reconstituted high-density lipoprotein drug has commenced and is a potential game-changer if successful. CSL expenses all R&D spend and is in a particularly high spend phase currently, given the recombinant trials. When this round of trials are completed, spend is likely to plateau or fall which when combined with revenue from product launches, is expected to accelerate profit growth.

We re-established a position in Asciano (no change) as we see management's focus on reducing the company's cost base and improving operational efficiencies as a positive in the face of lacklustre conditions in the ports and rail businesses. We believe that Asciano will be well positioned to leverage increased economic activity when it eventually returns to the sector. Further, we see the potential for corporate activity in the ports business as a material potential source of upside.

We opened a position in Stockland (up 7.3%) this quarter. Stockland is a diversified property group in Australia which develops and manages residential communities, retirement living villages, retail centres, office buildings and industrial sites. Stockland is well managed and we are attracted to its strong medium-term earnings growth underpinned by improving residential volumes, gradually recovering margins, returns on invested capital. Further, we see its low retail occupancy costs and strong relative productivity as positive drivers.

We established a new position in Seek (up 6.54%) during quarter. The company provides online classified and education and training services in Australia, New Zealand, China, South East Asia, Brazil and Mexico. The economies outside of Australia offer strong growth potential compared to the relatively mature businesses in Australia. Domestically the recent rebound in market conditions, still the largest business for the group, is material for near term earnings. However, the biggest driver over the medium to longer term is the combination of the international businesses, with Zhaopin in China the largest one of these. Success in these markets will position the group favourably in the long term. In summary cash flow growth and returns on capital are very attractive and we believe the stock is undervalued.

We acknowledge that the road to growth is not always going to be free from potholes. Vocation (down 91.0%) is a good example. It is a company we continue to hold as we believe it has significant future growth potential, although we acknowledge it has issues to overcome as it progresses forward. Since the announcement of a settlement with the Department of Education and Early Childhood Development (DEECD) and the completion of the Victorian review, the company has altered its enrolment mix as it works to regain a firmer footing. The company has also moved to bolster its executive ranks by recently announcing the appointment of Stewart Cummins as interim CFO. We are confident that given his background and skill set, Stewart will be a valuable asset to the business.

We reduced our position in Fonterra (up 4.3%) during the quarter. While we have benefited from our position in Fonterra for some time, we became uncomfortable with the level of fundamental business risk as they continue to ramp up capital expenditure. We are also concerned about the near term impacts of trade sanctions on Russia which is a significant market for dairy produce from Europe.

We exited Insurance Australia Group (up 2.1%) during the quarter after a period of strong share price appreciation. While the company remains on track for FY15 guidance we feel that the market is factoring in the upside and the current share price does not offer the required valuation upside.

The economic recovery in the US continues as evidenced by the upward revision to third quarter GDP and generally supportive economic data.

This remains a central theme in our portfolio construction. We are seeing the gradual normalisation of US monetary policy, ongoing recovery in the USD dollar and general upward pressure on US interest rates. We have chosen to play this central theme through tilting the portfolio towards those companies that have operations whose fundamentals that will be supported in this environment.

Reflecting this theme, Westfield Corporation (up 21.1%) and Goodman Group (up 12.1%) are currently held in the portfolio. Westfield is a global leader in the property sector with an outstanding management team and a world class global redevelopment pipeline with key flagship assets including the World Trade Centre retail precinct in New York and Westfield London. Goodman is one of the global leaders in the industrial property sector with strong businesses in property development, funds management and property expanding into new markets such as China, USA, and Brazil. As well as possessing strong fundamentals, we are attracted to both companies' offshore earnings and the positive building development, retail sales and leasing environment in the countries in which they operate.

James Hardie (up 11.1%) is another beneficiary of the US recovery. The company's predominantly US dollar earnings base has benefited directly from a lower Australian dollar and falling US bond rates have consequently reduced the costs of mortgages for American borrowers. James Hardie is also a beneficiary of lower energy prices through the use of gas in manufacturing and extensive use of heavy haulage to distribute its product. We believe that James Hardie continues to have a superior growth outlook as US housing construction recovers from below trend levels and the company achieves further success with its market penetration strategies.

While the US economic backdrop has provided a strong environment for QBE Insurance Group (down 3.7%), we elected to use the market strength to reduce our holding. While we continue to be supporters of the company, we believe that the impact of the recent fall in US bond yields on their investment earnings is not reflected in the current share price.

Chinese economic data has remained underwhelming.

The Chinese leadership face the reality of balancing long term reforms on corruption, the environment and market liberalisation with maintaining economic growth. Despite the weaker growth we have not observed any change of government policy; this is consistent with our view that the leaders are maintaining a long term view of China's growth trajectory.

As a result of the weaker Chinese and economic growth and the subsequent supply/demand imbalance in bulk commodities, we have seen declines in the large mining companies, namely BHP (down 13.3%) and Rio Tinto (down 2.7%). While both companies are low cost producers of bulk commodities and will likely weather the current weak patch, their softening cash flows mean that any significant capital return to shareholders are likely to be associated with rising debt levels which we do not think is prudent at this point of the cycle.

In contrast to the misfortunes of the broader metals sector, the position we hold in Sims Metal Management (up 8.3%) performed strongly over the quarter. Sims is currently undertaking a strategic plan focussing on internal initiatives in the form of cost-outs, productivity improvements and supply chain optimisation to generate earnings growth. We are comfortable with the progress that the company is currently making.

Orecobre (up 0.7%) is another company that we hold that bucked the December quarter resources trend. Orecobre is a lithium development company whose primary asset is the

Salar de Olaroz Lithium-Potash project in North-western Argentina. We remain attracted to the company's low cost position and large expandable resource base given the positive lithium industry dynamics. Our positive outlook is predicated on growing demand for mobile batteries and the increased penetration of electric vehicles which we see as a benefit for both the company and the global environment.

Domestically, consumer confidence and business conditions have continued to weaken and the Australian dollar will likely continue to slide.

There will be a transitory period between the current weakness and subsequent recovery of confidence as the falling Australian dollar should assist in rebalancing the Australian economy in the longer term. As such, we have maintained a general underweight position to the Australian retail sector.

In line with this theme, Woolworths (down 10.4%) is a company that we have elected not to own and this decision has been a solid driver of recent portfolio performance. Woolworths' decline started following the release of a disappointing Q1 sales number in their Food and Liquor department. The weak growth supported our thesis that Woolworths is not well equipped to deal with the rising level of competition in the markets in which it operates and is losing market share as competition escalates (namely between Aldi, IGA, Coles and Costco) in a weaker retail environment. Other Woolworths businesses: Petrol, New Zealand Supermarkets and Hotels have been reporting softer comparable sales in recent times and we remain concerned about the ongoing poor execution in Home Improvement.

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

This will create economic imbalances between countries leveraged to production and those leveraged to consumption.

While we entered the December quarter with an increasingly bearish view of the energy sector and had exited Oil Search in recent months based on this view, the sharp and severe way in which the theme played out meant that we had to act decisively in shaping the portfolio to reflect the changing fundamentals of the companies we held given the change in the world oil environment.

We moved to exit Santos (down 39.7%), Worley Parsons (down 34.3%) and MMA (previously Mermaide Marine Australia, down 35.8%). We believe that in the current environment there is an increasing probability that Santos will need to raise equity as its cash flow leverage to lower oil prices places its capacity to refinance in some doubt. This doubt has spread and was further reflected by the lowering of Santos' credit rating by S&P to BBB from BBB+. In conjunction with Santos, we strategically made the decision to exit Worley Parsons on the basis that we would likely see extensive cuts to capital expenditure stemming from the decline in oil prices and these are yet to be reflected fully in the share price. On a similar path we felt that the relationship of the operating environment relative to the debt levels of Mermaid Marine had deteriorated to a point where we could not safely hold the company for its future growth prospects.

Despite the slump, we continue to hold Sundance (down 57.1%). Sundance's current drilling program levels have been reduced to align the company's operating cash flows with its capital expenditure and thereby preserve the company's strong balance sheet. While this has negatively impacted our forecast production growth profile, we believe that it is the most sensible course of action for the company to take at this point in the cycle. The decision gives us confidence that CEO Eric McCrady can navigate the turbulent waters ahead and ensure the company emerges from this period of volatility in good shape.

We also continue to hold Karoon Gas (down 30.1%) as they continue to investigate their recent oil discovery at Kangaroo-2 in offshore Brazil. Flow rates expressed so far support an economic discovery and we expect further news in coming weeks. We continue to see significant valuation upside in Karoon Gas even with lower long term oil price assumptions and note that the company remains well capitalised with a forecast cash balance as at 31 December 2014 of $644m or $2.61/share, versus the share price as at 31 December 2014 of $2.44/share.

At the end of the month the month the trust held 41 stocks and had an effective cash balance of 2.9%.

Market overview

The major global equity market indexes were broadly stronger in the quarter, although categorically the returns were a function of the last half of the month of December. The North American indices yielded positive returns with the Dow Jones climbing 4.6%, the S&P 500 up 4.4% and the Nasdaq rising 5.4%. The Nikkei 225 was also a strong performer rising 7.9%. The worst performers of the major bourses were the FTSE 100 which fell 1.8% and Euro Stoxx 50 which declined 2.5%.

Some of the geopolitical risks that have been roiling markets began to diminish over the quarter. In Europe tensions between Ukraine and Russia eased while student led pro-democracy rallies in Hong Kong began to simmer out. Anti-terrorist military action stepped up in the Middle East and we feel that this may be a theme that continues.

Following the European Central Bank's (ECB) decision to reduce interest rates by 10 basis points in September, President Mario Draghi announced a two year program of asset purchases. This came as a weak November CPI reading of just 0.3% stoked fears of deflation risk. Coupled with tepid economic growth, levels of unemployment remained persistently high.

The US Federal Open Market Committee (FOMC) exited QE3 in October, as scheduled. A raft of solid economic data also saw the "considerable time" guidance, in reference to the first interest rate hike, removed from the FOMC minutes. Third quarter GDP bettered an already impressive second quarter rate of 4.6%, expanding at an impressive annual rate of 5.0% quarter on quarter. Non-farm payrolls gave solid readings of 243,000 in October and 321,000 in November and the unemployment rate ticked down 0.1% to 5.8%. Consumer confidence, as measured by the University of Michigan survey, continued its strong march forward, bettering a recent high of 84.6 in September to reach another of 93.6 in December. The ISM PMIs also continued to show strength as the manufacturing PMI in December remained at the elevated level of 59 achieved in September. The non-manufacturing PMI fell slightly from 59.6 to 59.3 in December although it remains firmly in expansionary territory.

Chinese third quarter GDP growth came in at 7.3% year on year, slightly ahead of the 7.2% print expected, but weak enough to prompt the People's Bank of China (PBOC) to announce cuts to benchmark interest rates. The one year benchmark deposit rate was reduced by 25 basis points to 2.75% and the one-year lending rate reduced by 40 basis points to 5.6%. December quarter economic data remained underwhelming. The HSBC manufacturing flash PMI came in at 49.6 in December against a reading of 50.2 in September. M2 money supply growth eased to 12.3% from 12.6% year on

year. New loan creation remained volatile falling to 548.3bn in October before rallying to 852.7bn Yuan in November. Fixed asset investment growth slipped to 15.8% year on year in November from 16.3% in September.

Domestically, the RBA left the cash rate unchanged at 2.5% over the December quarter reaffirming its view of a "period of stability" in interest rates. Economic data was relatively soft. NAB business confidence continued to slump, now having fallen almost 7 points from the August reading to a 1.2 reading in December. The NAB business conditions index fell to 5 in November from 13 in October and the Westpac MI consumer confidence index slumped to a low of 91 in December falling 3 points over the quarter. Jobs data once again provided a large surprise as the November figure registered a gain of 42,700 jobs, this was later revised down significantly to a 13,700 increase. Building approvals for November rose 7.5% for the month.

Commodity prices experienced significant declines as supply increased strongly over demand. Spot Brent Crude slumped 40.5% as the Organization of the Petroleum Exporting Countries (OPEC) retained their existing production target in the face of strong supply growth. In particular Libyan ports resumed exports and North American production increased. The benchmark Tianjin 62% Spot Iron ore contract declined 8.7% for the quarter as low cost producers continued to ramp up supply in the face of slowing Chinese demand. In other metals, copper fell 5.2%, zinc 5.0% and nickel 7.2%. Gold fell 1.9% over the period.

Environmental, Social and Governance (ESG)

In this section we have previously addressed a number of issues we've had with energy policy – particularly relating to renewables and carbon emissions. The problem is wider. Overall environmental policy in Australia is a mess. We don't know what the Renewable Energy Target will be, we don't know what state based solar rebates will be and we don't know what "direct action" is. There is no national body for addressing hydrocarbon extraction methods such as hydraulic fracturing (fracking). The fact that each State can have completely different rules, standards, exclusions and regulation at an environmental level, distorts that industry. Water standards are vastly different in every state for recycling, saline levels, usage and (of special importance to the Murray Darling basin) storage rights. Even the management of national parks are not co-ordinated at a national level. While most investors are aware of the frustrations in the energy industry from a policy vacuum, there are many other industries that have far too much cost imposed on them dealing with inconsistent regulations that change too often and are often based on very specific political issues in different states. While we have strong views on environmental protection and the responsibilities of companies to operate in a sustainable way, the environmental regulatory framework in this country does not help that outcome. We expect Greg Hunt (Federal Environment Minister) and his department to be doing much more.

Top 10 Holdings

Stock name	Trust weight %	Index weight %
National Aust. Bank	8.5	5.9
Commonwealth Bank	8.4	10.1
ANZ Banking Grp Ltd	7.4	6.4
Telstra Corporation.	7.2	5.3
Westpac Banking Corp	6.9	7.5
CSL Limited	5.7	3.0
Westfield Corp	3.4	1.2
James Hardie Indust	2.7	0.4
Sims Metal Mgmt Ltd	2.5	0.1
Challenger Limited	2.5	0.3

Asset Allocation

Sector	Trust weight %	Index weight %
Energy	2.2	5.1
Materials	10.7	15.0
Industrials	12.1	7.4
Consumer Discretionary	2.1	4.1
Consumer Staples	0.6	7.4
Healthcare	10.1	5.9
Financials-x-Real Estate	39.3	38.6
Real Estate	9.9	7.7
Information Technology	0.5	1.0
Telecommunication Services	7.2	5.8
Utilities	2.5	1.9
Cash	2.9	-

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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