PERENNIAL GROWTH MANAGEMENT

Perennial Socially Responsive Shares Trust

Quarterly Report
30 September 2015

	Quarter	FYTD	1 year	2 years	3 years	5 years
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Socially Responsive Shares Trust*	-2.4	-2.4	2.4	4.6	11.5	7.1
S&P/ASX 300 Accumulation Index	-6.5	-6.5	-0.7	2.5	9.1	6.3
Value Added (Detracted)	**4.1**	**4.1**	**3.1**	**2.1**	**2.4**	**0.8**
Net Performance	-2.7	-2.7	1.3	3.5	10.4	6.1

* 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 2015):
AUD3.9 million

Income distribution frequency:
Half yearly

Team FUM (as at 30 September 2015):
AUD2.3 billion

Minimum initial investment:
$25,000

Trust inception date:
December 2001

APIR code:
IOF0117AU

- **The Trust outperformed the Index by 4.1%.**
- **Best performers included Asciano Limited, Macquarie Atlas Roads Group and Veda Group Limited.**
- **We are looking for opportunities to invest in companies that are investing capital to sustainably grow their business.**

Trust performance overview

The Perennial Socially Responsive Shares Trust (The Trust) closed down 2.4% in the quarter, outperforming the S&P ASX300 Accumulation Index (the Index) by 4.1%, with the Index closing down 6.5%.

The Australian market followed a poor June quarter with an even worse September quarter. While Industrials (up 3.4%), Utilities (up 2.4%), Consumer Staples (up 1.5%) and REITs (up 1.1%) managed to generate positive returns, the vast majority of the index was in negative territory. Energy (down 24.1%), Resources (down 16.3%), Banks (down 11.3%) and Materials (down 10.8%) were the worst sectors in the Australian market for the period.

Quarterly Investment Themes and Stock Performance

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

Encompassing this theme we opened a new position in **Spotless** this quarter.

Spotless Group (Overweight, up 5.9%) has undergone a significant turnaround in the last three years, after spending two years under private equity ownership and 12 months back on the ASX with 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 a steady growth profile over the next three years (management guidance is for FY16 to materially exceed FY15 results), solid and improving return on invested capital and greater than 25% valuation upside.

Asciano Group Limited (overweight, up 26.3%) outperformed after it had received an indicative, conditional and non-binding takeover bid of $9.05 from Canadian Infrastructure firm Brookfield. Over the last four years Asciano has spent approximately $3b improving the quality and efficiency of its asset base and it was clear from the Port Botany tour in June that Patrick Stevedoring has a significant scale, productivity and cost advantage over its competitors Hutchison and DP World. In FY16 we forecast capex to decline and cash flow to improve materially driving up shareholder returns.

Veda (Overweight, up 23.7%) was another position that faced corporate activity. Veda received a non-binding cash expression of interest of $2.70 from US listed information solutions business Equifax, representing a 35% premium to the pre-announcement price of $2.00. Equifax is attracted to the strategic potential earnings from Veda's Comprehensive Credit Reporting (CCR) opportunity which is in its infancy in Australia. Veda's recent result was in-line with the expectations, however guidance for FY16 underwhelmed the market with NPAT growth guidance to be 'somewhat below' low

double digit EBITDA growth as management continues to invest in CCR. CCR is forecast to generate a strong uplift in earnings over the 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 15.9%) added to its 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 while CBA conducted 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.

Wesfarmers Limited (Restricted, up 3.3%) outperformed after reporting a slightly stronger than expected FY15 result, with underlying NPAT up 8.3%. The Coles and Bunnings divisions were the primary drivers of the result and they outweighed the moderate drag from Wesfarmers' resources exposure.

Sydney Airport (not held, up 19.7%) outperformed over the quarter after delivering a solid 1H15 result delivering growth in all parts of the business. Sydney also announced that it had purchased Terminal 3 back from Qantas before the expected date in 2019.

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 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. We have retained select exposures to China facing companies, these companies are in commodities or industries that have solid long term prospects and we believe these stocks should rebound once the shorter term growth concerns in China ease.

Encompassing this theme we entered a new position in **Alumina Limited** this quarter.

The market's reaction to Chinese economic weakness recently has weighed on **Alumina (Overweight, down 22.9%).** 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.

BHP Billiton (Restricted, down 14.9%) underperformed the market as commodity prices retreated significantly over the quarter. In terms of stock specific news BHP Billiton released their quarterly production report in which they provided FY16 volume guidance which disappointed relative to expectations. The biggest disappointments were in petroleum and copper where they guided to declining year on year volumes, down 7% and 12% respectively. We remain underweight BHP Billiton as we believe that their strategy of maintaining a progressive dividend results in the company forgoing investment opportunities that would likely generate returns significantly in excess of their cost of capital.

Bluescope Steel (Overweight, up 20.9%) continued recent outperformance as the company articulated their strategy to either successfully work with stakeholders to achieve at 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.

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, the market appears to be losing confidence that the first interest rate rise will occur this year. We are of the view that the theme remains intact and believe an interest rate hike would send a positive signal regarding the global economy.

Income producing stocks generally performed well after the Fed elected not to raise rates during September. Within this peer group **Macquarie Atlas (Overweight, up 25.7%)** performed particularly strongly given its offshore assets and earnings base. We believe that an additional driver of share price was the emerging realisation that the company's US assets may have material value following extremely high prices achieved in recent US toll road transactions. Macquarie Atlas' investment in Chicago Skyway could potentially be worth as much as 20 cents per share based on similar multiples, and the 50% of the Dulles Greenway could be worth well in excess of $1 per share. Both assets are currently in equity lock up (ie not contributing to current cash flows) and so simple yield-based valuations have failed to ascribe any value to these assets.

One of the portfolio's longest standing investments, in **James Hardie (overweight, down 1.6%)** 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. 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.

Westfield Corporation (Overweight, up 11.2%) and Henderson Global Investors (Overweight, up 5.7%) have both been strong portfolio performers recently and beneficiaries of the weaker AUD and we elected to trim these positions following recent outperformance.

Where is your Growth plan?

Where most segments of the market are still focussed on capital management, we are looking for opportunities in companies that are investing capital to sustainably grow their businesses.

Encompassing this theme, we added new positions in **Cochlear**, and **Qube Holdings** this quarter.

Cochlear (Overweight, up 0.7%) was one of the more interesting results from the reporting season, with 10% constant currency revenue growth driven by a very strong result in the Americas and 50% growth in processor upgrades. In addition, the FY15 result was very conservatively presented with $10m of one offs (inventory write-down and doubtful debt provision) taken above the line. The company now has arguably its most exciting product offer with clear industry leadership comprising: two electrodes, two implants, a relatively new processor with full wireless streaming capability, a hybrid system and a new generation BAHA (bone anchored) device. We believe that Cochlear is set for a period of strong earnings growth through a combination of product leadership, currency tailwind, and a new CEO ideally suited to commercialising the pipeline.

Qube Holdings (Overweight, down 0.6%) was added to the portfolio early in September after it was aggressively sold down by small cap managers following its inclusion into the ASX100. Qube has built a diverse business across Logistics and Port & Bulk services with the level of diversity providing some resistance in the challenging environment. New contracts and the full-year impact of acquisitions provide some support to FY16 earnings, while the strong balance sheet will ensure management can make further attractive acquisitions to continue to drive earnings growth. Qube is a business we know well and have owned in the past. We believe they have a first class management team who are executing their strategy well in the current environment.

Encompassing this theme, we bought **Healthscope (Overweight down 6.0%)** 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.

We added to **Sonic Healthcare (Overweight, down 7.6%)** which has a very strong growth outlook in FY16 (guiding to 18% EBITDA growth) due to a combination of organic growth, the Medisupport acquisition in Switzerland and favourable currency translation. The stock was sold off due to cancellation of the Alberta outsourcing contract and general concerns over cuts to government healthcare budgets; this has provided an attractive entry point. We believe that the company's scale advantage and strong market positions in Australia, UK and Europe will allow it to continue to achieve superior ROIC and deal with any funding cuts, which in any case are not likely until FY17.

We exited our **Dulux (Sold, down 5.0%)** position during the quarter. The stock has traded solidly (in relative performance terms) since reporting a disappointing interim result and had limited valuation upside. The interim result comprised an extremely strong result from the core Australian Paint division, offset by poor results from B&D Garage Doors and Parchem Construction Products. We believe that risks are to the downside for the upcoming full year result, given the possibility of reversion from the Paint Division and unfavourable movement of the Australian dollar/New Zealand dollar exchange rate. In addition, the company is testing consumer loyalty to the Dulux brand, by raising prices to the extent that the price differential to competing products is almost 10%. Market share trends from here will be interesting to monitor.

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 26.7%)** and **Sundance Energy Australia (Overweight, down 43.6%)**. 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 month end share price of $1.93 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.

Market overview

Despite the Australian stock market struggling over the quarter, it was not the worst performing of its global peer group. In the US, the Dow Jones fell 7.6%, the S&P 6.9% and the Nasdaq 7.4%. Europe fared little better, with the FTSE 100 falling 7.0% and the Euro Stoxx 50 down 9.5%. Asia was the worst performing region with the Chinese CSI 300 Index falling 24.7% and the Nikkei 225 falling 14.1%.

The US Federal Reserve announced that US interest rates would remain on hold in September. In what amounted to a tactical retreat, the Fed's policy statement cited "Recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term". The statement also added that while risks to the US economy were close to balanced, it was "monitoring developments abroad". While the Fed's decision was intended to support global markets, the accompanying negative commentary was interpreted as a lack of confidence in global growth prospects. A global equities sell-off ensued.

US economic data continued its generally positive trend. In August, it was shown that the US economy expanded 3.7% in the June quarter, ahead of the 3.2% expected and the 3.2% prior. After soaring 4.3 points in July, the August ISM non-manufacturing PMI trimmed a little of its gain with a reading of 59.0, while remaining ahead of the 58.2 expected. The August ISM manufacturing PMI, while remaining in expansionary territory, decreased 1.6 points from July to 51.1, behind the 52.5 expected. Housing starts declined 3.0% in the month of August after two strong consecutive prior periods of gains amounted an approximate increase of 10%. Labour market conditions remained firm as the unemployment rate fell from 5.3% in July to 5.1% in August. Nonfarm payrolls remained in positive territory totalling 140,000 in August, below the 204,000 expected and 210,000 prior. The participation rate remained steady at 62.6%. Headline CPI for August fell 0.1% for the month in line with the 0.1% fall expected, reversing the 0.1% gain in July.

Late in August the Peoples Bank of China (PBOC) lowered the one-year lending rate by 25 basis points to 4.6%, and adjusted down the one-year deposit rate by 25 basis points to 1.75%, as they clearly remained concerned about weakness in the economy. Chinese data has remained disappointing. The Caixin Manufacturing PMI continued its downward trend resulting in a preliminary reading of 47.0 in September, lower than the 47.5 expected and the 47.3 reading recorded in August. China's August CPI increased 2.0% for the year, greater than the 1.8% increase expected and July's reading of 1.6%, while PPI deflation accelerated to -5.9% for the year against the -5.6% expected and the prior reading of -5.4%. M2 money stayed steady at 13.3% y/y in August, in line with the 13.3% expected and up from the 13.3% in July. New loan creation totalled 809bn Yuan in August against the 850bn Yuan expected and the 1480bn in July.

Toward the end of the quarter, the spotlight fell on the commodity space after an analytical report questioned the balance sheet strength of global commodity trader, Glencore. The resultant circa 30% fall in the share price and subsequent rout of the commodity market highlighted the increasing concern around the balance sheets of mining companies given current commodity prices and shed a spotlight on commitments to the aggressive dividend policies many are adopting. The Australian market's broad 3.8% fall (S&P/ASX 300 Accumulation Index) the day after the analysis was released reinforced the global view of the country's reliance on the resources industry.

In Australia, 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 which may suggest early signs of a response to a lower currency.

The Australian economy continued to generate mixed readings over the quarter. Of particular interest, building approvals for August fell 6.9%, significantly more than the 2% decline forecast. While the building approvals series is typically volatile, it is widely thought that the restrictions on investor lending that APRA has implemented are beginning to take hold. Adding to this effect, it is believed that residential construction for Chinese investors has slowed on concerns the Chinese government will restrict capital outflows and prevent Chinese buyers from settling on property purchases.

Australian retail sales declined 0.1% in the month of August, behind the expected 0.4% growth expected and the previous reading of 0.7% in July. The labour market was positive in August with 17,400 jobs created, ahead of the 5,000 expected. The unemployment rate remained unchanged at 6.2%. After experiencing strong falls in business conditions and confidence in July, NAB business conditions rose 5 points in August to a reading of 11, while NAB business confidence continued to fall, declining to 1 from 4 points. This may reflect the divergence of current business conditions to a more pessimistic view of the future.

In bond markets, yields rose over the quarter. The move was a result of the consecutive impacts of negative Chinese data, the US Federal reserve appearing to elevate offshore economic concerns and the focus on the deterioration of balance sheets in the mining sector. This resultant period of broader uncertainty and weaker equity markets led to longer term bonds benefitting from flight to quality flows towards the end of the period.

Against this backdrop, the yield on the three year government bond ended the quarter 20 basis points lower at 1.80%. At the longer end of the curve, the yield on a ten year government bond ended the quarter 40 basis points lower at 2.61%. These moves meant that the Bloomberg AusBond Composite Index gained 2.2% over the September quarter. The cash sector, as measured by the Bloomberg AusBond Bank Bill Index, ended the quarter 0.54% higher.

Environmental, Social and Governance (ESG)

Every now and again an unprecedented failure of corporate governance is seen somewhere around the globe.

Enron's bankruptcy in 2001 provides one example, after it admitted that its reported financial condition was sustained substantially by institutionalised, systematic and creatively planned accounting fraud. In 2011 camera maker Olympus provided another, after the company admitted that it had been hiding losses going back more than 20 years by using acquisitions to hide the company's true financial performance.

This quarter, Volkswagen has provided another example that will likely be studied and quoted as one of the great corporate governance failures of our time.

On the 18th of September the US Environmental Protection Agency (EPA) issued a Notice of Violation of the Clean Air Act to German automaker Volkswagen Group. The EPA had had found many VW cars being sold in America had devices in their diesel engines that could detect when they were being tested and change the performance of the engine accordingly, to improve results. The result of the cheating meant that despite passing laboratory testing, the engines emitted nitrogen oxide pollutants up to 40 times above what is allowed in the US when on the road. Volkswagen has since come out and has admitted to the cheating devices not only in the US but across the globe, they have estimated that up to 11 million cars worldwide could be affected.

Of interest, the European Commission's Joint Research Centre published a report which found that all tested diesel vehicles substantially exceeded the respective Euro 3-5 emission limit. As early as 2013 the research centre warned that "Sensors and electronic components in modern light-duty vehicles are capable of 'detecting' the start of an emissions test in the laboratory".

In immediate response the scandal, Volkswagen has recalled almost 500,000 cars in the US alone and set aside 6.5bn Euros to cover costs and the chief executive of VW, Martin Winterkorn, resigned on the 23rd of September. VW has also launched an internal enquiry.

Best/Worst Performers			
(Best) company	Quarterly Return	**(Worst) company**	Quarterly Return
Asciano Limited	26.3	Wesfarmers Limited (not held)	3.3
Macquarie Atlas Roads Group	25.7	Sundance Energy Australia Limited	-43.6
Veda Group Limited	23.7	Karoon Gas Australia Ltd	-26.7
BHP Billiton Limited (not held)	-14.9	ANZ Banking Group Limited	-15.9
Bluescope Steel Limited	20.9	Sydney Airport (not held)	19.7

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New/Increased positions	
Cochlear Limited	New
Qube Holdings Ltd	New
Alumina Limited	New
Spotless Group	New
Healthscope	Increased

Exited/Decreased positions	
Duluxgroup Limited	Exited
CSL Limited	Exited
Henderson Group	Reduced
Westfield Corp	Reduced
James Hardie Indust	Reduced

Top 10 Holdings		
Stock name	Trust weight %	Index weight %
Westpac Banking Corp	9.4	7.1
ANZ Banking Grp Ltd	8.4	5.9
National Aust. Bank	7.2	5.9
Commonwealth Bank.	6.8	9.3
Asciano Limited	4.5	0.6
Caltex Australia	4.0	0.6
Westfield Corp	3.7	1.4
Macquarie Group Ltd	3.7	1.9
Incitec Pivot	3.6	0.5
Telstra Corporation.	3.5	5.2

Asset Allocation		
Sector	Trust weight %	Index weight %
Energy	5.6	4.0
Materials	12.7	13.9
Industrials	15.0	8.0
Consumer Discretionary	4.9	4.7
Consumer Staples	0.0	7.1
Healthcare	6.6	6.4
Financials-x-Real Estate	43.7	38.4
Real Estate	3.7	8.4
Information Technology	0.0	1.1
Telecommunication Services	3.5	5.7
Utilities	3.3	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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