Perennial Socially Responsive Shares Trust

Quarterly Report
31 March 2014

	Quarter	FYTD	1 year	2 years	3 years	5 years
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Socially Responsive Shares Trust*	2.2	19.6	15.1	16.3	8.5	13.4
S&P/ASX 300 Accumulation Index	2.0	16.3	13.0	16.0	8.1	13.2
Value Added (Detracted)	**0.2**	**3.3**	**2.1**	**0.3**	**0.4**	**0.2**
Net Performance	2.0	18.7	14.1	15.3	7.5	12.3

* 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 March 2014):
AUD47.7 million

Income distribution frequency:
Half yearly

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

Minimum initial investment:
$25,000

Trust inception date:
December 2001

APIR code:
IOF0117AU

- **Despite a weak start, Australian equity markets recovered in February and March to post modest gains for the quarter.**
- **Mayne Pharma (up 27.7%) was the Trust's top contributor for the quarter.**
- **Commodity markets were mixed over the quarter.**

Trust performance overview

The Perennial Socially Responsive Shares Trust (the Trust) closed up 2.2%, slightly ahead of the S&P/ASX300 Accumulation Index (the Index) return of 2.0%.

The top contributor during the quarter was Mayne Pharma (up 27.7%). The company provided its interim financial results which showed NPAT for 1H14 to be $8.4 million, which came in ahead of market expectations. The company also announced the acquisition of the ESGIC and LORCET brands from Forest Laboratories, with the company forecasting the acquisition to be single digit EPS accretive within its first full financial year. Management have continued to execute on their plan of turning Mayne Pharma into a diversified global pharmaceutical company and they have a number of products which will help them to continue to grow.

BHP Billiton (not held, down 4.0%) also added as growing concerns around the economic outlook in China weighed on commodity prices and the listed resource sector, with BHP Billiton underperforming the broader market. Wesfarmers (not held, down 6.5%) was also impacted by investor concern around the outlook for metallurgical coal weighing on the share price while Target continued to underperform. Additionally, the ACCC announced that it was not opposed to the company's proposed sale of its insurance underwriting business to Insurance Australia Group, with the NZCC expected to provide a decision at the end of April. We share the market's concern on the outlook for metallurgical coal, and based on our fundamental valuation of Wesfarmers, see the company as being overvalued at current levels.

AMP (up 13.4%) also performed strongly after announcing its FY13 full year result which saw NPAT come in at $672 million and exceeding market expectations by around 2%. The market had been particularly cautious of AMP's Wealth Protection business going into the result and with no further negative news announced on this division the stock saw a re-rating.

The Trust's biggest detractor to performance was Karoon Gas (down 41.0%) as a lack of news flow due to delays in achieving farm outs for its key assets in Brazil and Australia resulted in the stock underperforming the market. The delays in achieving a farm out reflects the current market conditions for energy exploration where shareholder demands to return cash flows have resulted in a distinct lack of activity in this space. We remain confident that the Karoon management team can secure the necessary farm downs which in turn will underline our assessment of the quality of these assets. We believe that Karoon is significantly undervalued and see material valuation upside.

Infigen Energy (down 23.1%) was weaker with political uncertainty around a number of areas of environmental legislation remaining high. We see heightened risks to changes being made to existing renewable energy targets by the Coalition Government. Any changes have the potential to adversely impact Infigen Energy's revenues as it currently benefits from selling renewable energy certificates to companies to cover their own renewable targets. This uncertainty has weighed on Infigen Energy's share price and the stock underperformed the market.

ResMed (down 10.4%) also detracted value. The US President's 2015 Budget included a number of durable medical equipment (DME) related proposals which if implemented could lower Medicare reimbursement for ResMed. ResMed's recent quarterly results have been slightly below expectations as competitive bidding appears to be impacting price and volume in the short term. However, our research indicates the impact will abate going forward due to more favourable price outcomes and new product launches. The stock is heavily shorted by US hedge funds on the competitive bidding thematic, but it is important to remember that Medicare represents only around 10% of group revenues. Our valuation still sees significant upside and our forecasts already factor in slower US growth due to competitive bidding.

WorleyParsons (down 8.8%) also detracted from performance as concerns around reduced capex plans by the world's oil majors weighed on the share price, with Exxon the latest to announce a reduction to its investment spending. WorleyParsons released a solid first half result in February which delivered a very strong cash flow outcome as well as providing increased disclosure around the issues previously faced by the company in its Canadian fabrication business in a contract which is now complete. The company continues to enjoy considerable momentum in winning new contracts, particularly within its Canadian oil sands business and we believe that it offers significant valuation upside.

Market overview

Despite a weak opening to the calendar year, equity markets recovered in February and March to post modest gains for the quarter. With weaker iron ore, coal and metals prices, the materials sector was the worst performer and the only one to post a negative return, falling 0.7%. The more defensive sectors of utilities, REITs and banks all posted positive returns of over 3% for the quarter.

The March quarter was mixed for global equity markets. With the exception of a 9% fall in the Japanese Nikkei225, most markets saw modest moves of between plus and minus 3%. This was despite a number of negative factors, such as poor economic releases from China and the Russian annexation of Crimea, during the period.

In Australia, the Reserve Bank of Australia (RBA) left the cash rate on hold. However, the bank moved to a more neutral stance in February citing a period of "stability in interest rates" which was in contrast to the clear easing bias held during the December quarter. Strangely, the commentary also dropped references to the Australian dollar being too high.

The Australian unemployment rate ticked up to 6.0% over the quarter from a reading of 5.9% in December, but added over 65,000 jobs, while consumer sentiment and business confidence indicators were subdued, building approvals remained strong. House prices continued to rise and auction clearance rates (especially in Sydney) remained at healthy levels. GDP growth for the fourth quarter 2013 was a solid 0.8% driving overall economic expansion of 2.4% year on year.

The 2014 February profit reporting season identified several clear – and consistent - themes: ongoing cost reductions, muted top line sales growth and high dividend payout ratios. Outlook comments remained cautious, but with many companies noting that conditions had now stabilised and, in some cases, early signs of better activity evident. M&A activity was light with Myer and David Jones in merger talks, Telstra selling both the remnants of Sensis/Yellow Pages and its Hong Kong based mobile business CSL, and Seek bidding $580 million to acquire the outstanding stock in Asian based JobStreet. Elsewhere, AGL had its $1.55 billion bid for NSW electricity generator, Macquarie Generation, blocked by the ACCC, a decision it will appeal, Wesfarmers sold its insurance underwriting business to IAG and Commonwealth Property Office Fund was acquired by Dexus and CPPIB.

It was a strong month for the Australian dollar, with the AUD/USD rallied 3.9% to 0.9266 as improving domestic economic data pushed the Australian dollar higher. A number of emerging market currencies declined early in the quarter as risk aversion to these regions increased and US Federal Reserve tapering commenced in January.

Commodity markets were mixed over the quarter, with concerns of slowing Chinese growth weighing on iron ore (down 13.0%) and copper (down 9.7%) prices, while despite the ongoing unrest in Ukraine energy markets were stronger with Brent (up 2.7%) and WTI (up 3.2%) both performing better. The Indonesian nickel ore export continued to have an impact on the price with nickel (up 14.4%) having a solid quarter. In light of the rising tensions around emerging markets and Ukraine, gold performed better rising 6.5%.

Environmental, Social and Governance (ESG)

In recent reports we have touched on the likely removal of the carbon tax and a winding back of the Renewable Energy Target (RET) scheme. The direct impact of the carbon tax removal on company earnings will be modest. Major emitters are currently receiving offset credits covering the majority of their costs, so its removal will make little difference. Consumers may see one or two cents per KWh come off their electricity bills, but given most people do not know what they pay per KWh (generally 25 to 30 cents if you were wondering), again, it will not make much difference.

The winding back of the RET will have impact on renewable energy investments and we have suffered the price decline of Infigen Energy as a consequence. While no final decision has been made, the current mutterings from Canberra look particularly negative for the billions of dollars that have been invested in that industry over the past decade.

A curious and troubling aspect of Australian energy markets that we thought worth highlighting is the marginalisation of gas as a source of power generation fuel. Unlike the US, which has seen a sharp drop in energy prices with the discovery of huge reserves of shale gas, in Australia, where we have also discovered vast new reserves of coal seam gas (CSG) over the past decade, the contract price has tripled. With the export of this gas (and previously existing reserves) via large LNG plants, there is now a shortage on the East Coast of Australia. Consequently, gas is no longer economic to generate electricity and we will shift back to a greater reliance on coal. This is the reverse of the US, where gas generation is replacing coal. While renewables are still increasing in Australia, our national carbon footprint will grow rather than shrink due to the dramatically changed energy dynamics we have seen over the past couple of years.

With this outcome already set, the Government decision on the RET review takes on more importance for any chance of carbon emission reduction. The debate seems to have been avoided, but it is an issue that is vital for the shape of domestic energy markets in the future.

Top 10 Holdings

Stock name	Trust weight %	Index weight %
ANZ Banking Grp Ltd	8.4	6.7
Commonwealth Bank.	7.4	9.2
Westpac Banking Corp	7.1	7.9
National Aust. Bank	7.0	6.1
CSL Limited	4.7	2.5
Westfield Group	3.2	1.5
Lend Lease Group	3.2	0.5
QBE Insurance Group	3.0	1.2
AMP Limited	2.8	1.1
ResMed Inc.	2.8	0.3

Asset Allocation

Sector	Trust weight %	Index weight %
Energy	10.0	5.8
Materials	10.4	17.4
Industrials	11.3	6.8
Consumer Discretionary	0.7	4.8
Consumer Staples	0.0	7.9
Healthcare	10.3	4.7
Financials-x-Real Estate	42.1	38.2
Real Estate	8.7	6.7
Information Technology	0.0	0.8
Telecommunication Services	2.4	5.1
Utilities	2.0	1.6
SPI Futures	0.0	-
Cash	2.1	-

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