JENCAY capital

AFS Licence Number 402024
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Jencay Australia Investment Fund

Quarterly report – 31 March 2014

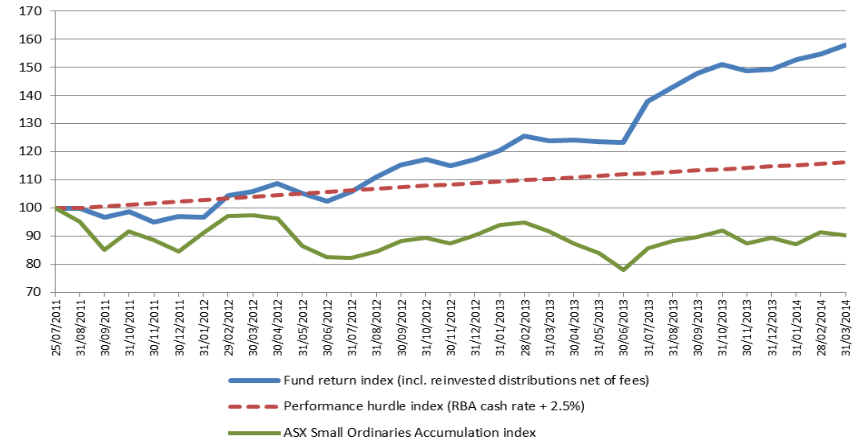
Performance

Returns are net of fees, exclude buy/sell spreads and assume reinvestment of distributions/income	Since inception (annualised)	Latest 12 months	Latest Quarter
Fund total return	**18.5%**	**27.1%**	**5.5%**
Performance hurdle (RBA cash rate + 2.5%)	5.8%	5.2%	1.2%
ASX Small Ordinaries Accumulation Index	(3.7%)	(1.5%)	0.9%

Unit Price

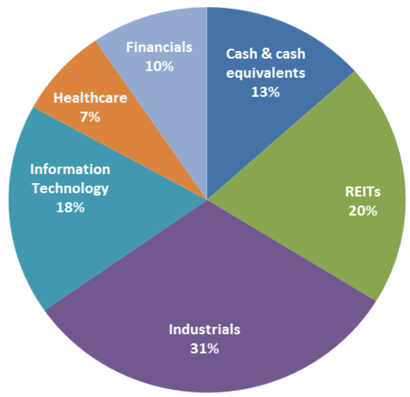
NAV per unit		**AUD 1.477**
Application price	(0.5% spread added)	AUD 1.485
Redemption price	(0.5% spread deducted)	AUD 1.470

Performance Chart



The chart tracks the movement in value of AUD100 invested in the Fund at inception, relative to the Reserve Bank of Australia cash rate plus 2.5% (performance hurdle) and relative to the ASX Small Ordinaries Accumulation index. Returns are net of fees, exclude buy/sell spreads and assume reinvestment of distributions/income.

Fund Composition



Fund size : **AUD 15.0m**

Industrials have been segmented further into Industrials, Information Technology and Healthcare due to the Fund's growing exposures in IT and Healthcare

Market returns for the quarter were relatively flat with the ASX Small Ordinaries up 1% and the ASX All Ordinaries Index up 2%. The Jencay Australia Investment Fund had a comparatively good quarter, and was up 5%. Galileo Japan Trust, described below, replaced Mirvac Industrial Trust in the Top 10. The cash weighting increased from 9% to 13% due to a combination of inflows and modest selling. Following a stellar run, Enero's weight became too large in the portfolio and we trimmed it down to more appropriate levels.

Top 10 Positions

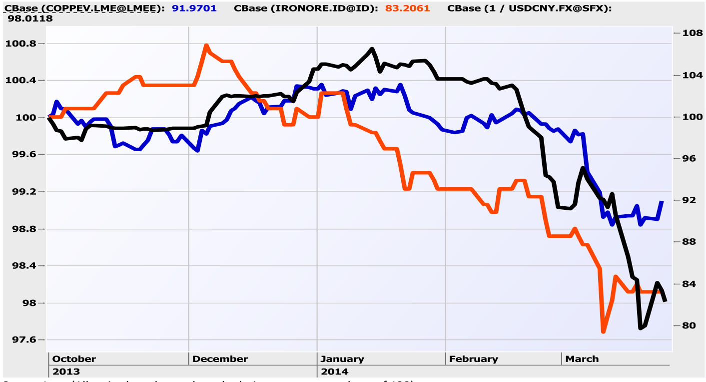
Weight %	Name	Summary Investment Case
13	**Cash & cash equivalents**	Approximately 40% of the cash is held in an ASX listed exchange traded fund whose only asset is a USD call deposit with JP Morgan. The remainder is on call deposit with the custodian, JP Morgan and is denominated in AUD.
6	**Reckson New York Property Trust**	Real Estate Investment Trust (REIT) holding suburban office property in the New York tri-state area. The share price is less than 60% of RNY's NTA (net tangible asset value) indicating limited downside but still substantial upside which would benefit from improving portfolio occupancy and/or further declines in the AUD.
5	**Enero**	Enero contains the remaining creative, marketing and PR businesses of the failed Photon group. The share price moved up further following their half year reporting in February and has tripled since we initiated the position 15 months ago. We trimmed the position but have not sold out completely because we believe the share price does not yet reflect the full potential of the underlying businesses.
5	**Thinksmart**	Provider of consumer credit via leading electronics and other retailers. After the recent sale of their challenged Australian business, the group will be left to focus exclusively on its attractive and growing UK business. With available cash of $30m to pursue UK growth, the business, which should generate circa $7m in PBT, is being valued at $35m (a very reasonable 5x).
5	**Austal**	The world's leading aluminium ship builder. It has secured two US Navy contracts to produce 20 ships that will keep Austal's US facility in full production to 2019. The cash flows to be produced from the US Navy contracts alone justifies the current share price with the Australian and Philippine ship yards plus the service business and any future orders coming free.
5	**Australian Vintage**	Australia's second biggest wine producer holding the title of "International Winemaker of the Year" for two of the last three years. AVG had a disappointing first half and was sold down by about 20%. Agriculture companies are notoriously unpredictable in the short term but over the medium term we expect earnings to improve substantially due to growth in higher margin branded wine sales, a weaker AUD, and the rolling off of some onerous grape supply contracts. Despite the improving outlook, it trades on a P/E of less than 8x expected 2014 earnings.
5	**GBST**	Leader in the provision of stockbroking and wealth management platform software. Many of their products are world class which is driving strong growth in the UK, US and Asia. GBST's share price has more than doubled since we initiated a position just over a year ago and as a result upside has reduced. It now trades on a prospective EV/EBITA multiple of 13x which we believe is still reasonable for a company with GBST's attractive qualities and strong growth prospects.
5	**Servcorp**	Market leader and world's second biggest serviced office business behind Regus. Founder and CEO owns 50%. 1/4 of its market cap is backed by cash, with no debt due to its prolific cash generation. The 4% dividend yield should grow in excess of 10% p.a. - attractive for a quality company with good management and a large portion of earnings generated outside Australia.
4	**Galileo Japan Trust**	REIT holding office, retail and residential property in Japan, primarily Tokyo. GJT has held a small position in the Fund since its inception but we recently increased its position via participation in a company saving capital raising. It is currently trading at 70% of NTA and on a (tax deferred) distribution yield of 10%. It appears that the Japanese property cycle has bottomed with an expectation that rentals and valuations will improve. In contrast to GJT, Japanese domiciled REITS are currently trading above NTA.
4	**Australian Education Trust**	REIT owning 351 childcare centres spread throughout Australia which it rents out on triple net leases with 8 years of average term remaining on the leases. Although the Fund has enjoyed strong returns from AEU, its 2014 expected distribution yield is a healthy 7% which we expect to grow at least in line with inflation.

Some observations over the quarter

The quarter saw some interesting movements in Copper and Iron Ore prices, the Chinese Yuan and some high profile defaults in China. The risks surrounding China are being discussed more frequently in mainstream media and elsewhere. A couple of the important topics are highlighted below:

1. Copper, Iron Ore and the Yuan

Is it merely coincidence that the price of copper (blue line), iron ore (red line) and the Yuan (CNYUSD, black line and LHS axis) dropped almost simultaneously as shown on the chart below?



Source:Iress (All series have been plotted relative to a common base of 100)

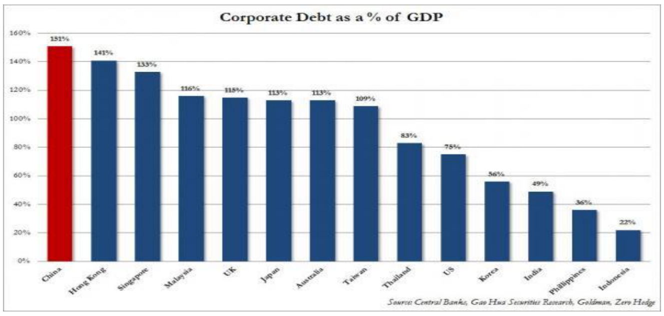
Based on explanations provided by various market commentators, it appears that for some time prior to recent events, traders had been acquiring copper and iron ore in order to collateralise USD loans. The proceeds of the USD loans were then invested in higher yielding Yuan deposits or Chinese wealth management products. Over the last few years, this speculative trade would have been very profitable based on a positive interest rate spread (between the high Yuan deposit interest received and low USD interest paid) as well as a rising Yuan (relative to the USD). A perception existed that the Yuan could only appreciate relative to the USD, as it had done up to this point. The trades would have artificially boosted Iron Ore and Copper demand prior to recent events.

We are not certain what initiated the drops illustrated above, but it would have led traders and lenders to question the ongoing viability of the "riskless carry trade" prompting the unwinding of some of their positions, further impacting the commodity prices and currency markets.

2. China Debt

With two recent high profile defaults in China, the extent of the debt amassed in China has been in the spotlight. Some of the more concerning numbers we have stumbled onto are discussed below:

- China's banking assets (at roughly \$24 trillion) represent approximately 1/3rd of World GDP. The growth in their banking assets over the last 5 years alone, at US\$15 trillion (ignoring the staggering growth in their wealth management products), is equivalent to the US's total overall banking assets, that took over a century to amass.
- China's corporate debt, at 150% of GDP, is amongst the highest in the world as illustrated by the chart below:



There are many commentators who debate the extent and timing of the fallout from China's binge years. We cannot shed too much further light on what has already been debated at length, however our takeaways in terms of managing your investment in Jencay are as follows:

It is no coincidence that China's debt has been rising in lockstep with excessive and growing vacancy in Chinese commercial and residential property as well as unutilized capacity in infrastructure and manufacturing. The outstanding commodity upcycle we have witnessed in recent years seems to have been built (at least partially) on the flimsy foundation of excessive Chinese debt and speculation.

"Trees do not grow to the sky" is an old adage that comes to mind when considering China's investment boom. We will continue to avoid exposures that have benefitted from China's debt and investment bubble such as Resources and the Australian Dollar, as we believe downside still massively exceeds any upside potential over the medium to longer term. In the short term the tree may well add a few more inches.

Fund Key Features

Comprehensive Terms are contained in the Information Memorandum which can be downloaded from the website www.jencay.com.au or sent to you upon request

Custodian	JP Morgan Chase Bank N.A.
Administrator	White Outsourcing Pty Ltd
Fund auditor	PricewaterhouseCoopers
Inception	25 July 2011
Investment strategy	The Fund seeks to generate attractive risk-adjusted returns over the long term and protect capital by buying securities trading significantly below fair value (bargains) and holding cash on deposit when bargains are not available in the market. The Fund has a small cap bias in accordance with the Manager's opinion that the majority of bargains are found amongst small caps.
Product type	Wholesale managed investment scheme available to wholesale clients and sophisticated investors
Investment universe	All securities listed on the Australian Securities Exchange (ASX) and cash to be held on deposit
Fund size cap	$200 million in net subscriptions. To manage liquidity the Trustee may limit the quantum of monthly inflows.
Investment restrictions	▪ Maximum of 40 individual securities ▪ Maximum exposure of 15% to a single security ▪ No short positions ▪ No leverage ▪ A maximum of 10% of the fund can be invested in companies with no earnings history such as biotechnology, resource exploration, new technology
Minimum initial investment	\$100,000
Minimum additional investment	\$20,000
Minimum redemption amount	\$20,000
Base management fee	1% p.a. excluding GST. Management Expense Ratio 1.025% p.a. inclusive of non-recoverable GST.
Performance fee	20% of returns above the Hurdle rate subject to a high water mark. The Hurdle rate is the Reserve Bank of Australia Cash Rate Target plus 2.5%.
Entry fee	None
Buy spread	0.5%
Sell spread	(0.5%)
Redemption notice	6 months' redemption notice required otherwise 5% early exit penalty to be applied

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