JENCAY capital

AFS Licence Number 402024
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Jencay Australia Investment Fund

Quarterly report – 30 September 2013

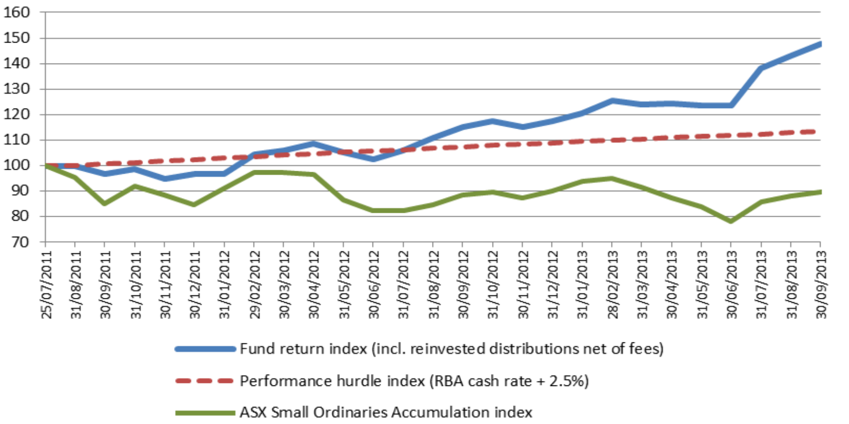
Performance

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	**19.8%**	**28.3%**	**19.6%**
Performance hurdle (RBA cash rate + 2.5%)	5.9%	5.5%	1.3%
ASX Small Ordinaries Accumulation Index	(4.9%)	1.4%	14.9%

Unit Price

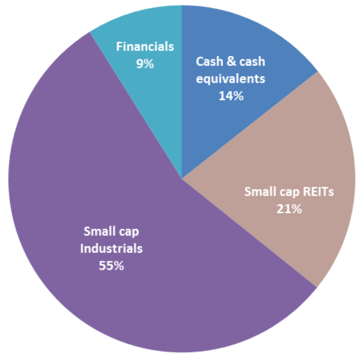
NAV per unit		**AUD 1.3850**
Application price	(0.5% spread added)	AUD 1.3919
Redemption price	(0.5% spread deducted)	AUD 1.3781

Performance Chart



The chart shows 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 12.8m**

During the quarter, small caps outperformed large caps for the first time in a while (see commentary on the next page) with the ASX Small Ordinaries Index up 15% and the ASX All Ordinaries Index up 12.5%. The Jencay Australia Investment Fund enjoyed a strong 20% return for the quarter, after fees. Many of the stocks in the Fund are up significantly and although the temptation to trim some of the positions is great, we have largely resisted because most are still priced well below fair value and below our exit target prices. A new stock, Altium, edged Mirvac Industrial Trust out of the top 10.

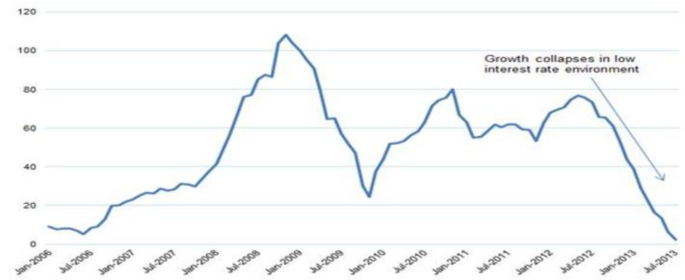
Top 10 Positions

Weight %	Name	Summary Investment Case
14	**Cash & cash equivalents**	Approximately 60% of the cash is on call deposit with the custodian, JP Morgan and is denominated in AUD. The remainder is held in an ASX listed exchange traded fund whose only asset is a USD call deposit with JP Morgan.
7	**Australian Vintage**	Australia's second biggest wine producer. The company has emerged from an extremely tough period due to a wine glut and the high Australian dollar rendering its exports (half of its production) unprofitable despite holding the title of "International Winemaker of the Year" for two of the last three years. Our exposure to the company increased after the Fund took up its entitlements in a recent capital raising that will see the company's debt drop to more appropriate levels. It trades on a P/E of less than 10x last year's earnings even though wine fundamentals are improving and the recent drop in the Australian dollar should boost profits significantly.
7	**Reckson New York Property Trust**	Real Estate Investment Trust (REIT) holding suburban office property in the New York tri-state area. Although RNY has doubled in price over the year, it still looks cheap based on a share price that is less than 60% of its Net Tangible Asset value (NTA) and the expectation of some recovery in the underlying property markets.
7	**Enero**	Enero contains the remaining creative, marketing and PR businesses of the failed Photon group. With the group now debt free, new management is pushing hard to restore value and reignite growth in the remaining businesses, many of which are market leaders in their respective fields. Although the share price has doubled since early June, we believe significant upside still remains if a turnaround can be achieved.
6	**Thinksmart**	Provider of consumer credit via leading electronics and other retailers. Following a few tough years due to deflation in computer pricing (core product for financing) and a change to a more conservative method of accounting which hit profits in 2012, earnings should now trend back up, assisted by exciting new products and growth initiatives. Although the price has doubled since we initiated our position in mid-2012, we believe it still offers good upside, based on a P/E of less than 10x 2014 projected earnings and further strong growth.
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 2018. 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 business coming free.
5	**GBST**	Leader in the provision of stockbroking and wealth management platform software in Australia. Many of their products are world class resulting in strong growth in the UK, US and Asia. GBST's share price has more than doubled since we initiated a position 6 months ago and as a result upside has reduced. It now trades on a prospective EV/EBITA multiple of 12x which we believe is still reasonable for a company with GBST's attractive qualities and 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. Enterprise value is approximately 5 times our estimate of EBIT in three years' time which is cheap for a company with good management, strong long term growth potential and a large portion of earnings generated outside Australia.
4	**Altium**	World leader in the provision of packaged software enabling the design of Printed Circuit Boards by electronics engineers. The majority of revenues, which are growing at double digit percentages, are generated outside Australia and costs are relatively fixed providing good operational leverage. Despite the stock price having jumped 80% since we bought in around April/May this year we believe it is still well priced based on a 2014 prospective EV/EBITA multiple of 10x and a dividend yield approaching 5%.
4	**Australian Education Trust**	REIT owning 333 childcare centres spread throughout Australia which it rents out on triple net leases with 9 years of term remaining. Although the Fund has enjoyed strong returns from AEU, its 2014 expected distribution yield is approximately 8% which we expect to grow at least in line with inflation.

Some observations over the quarter

Risk appetite

The past quarter saw a big improvement in investor risk appetite (probably due to good returns on the market in the previous year, not necessarily improving fundamentals). This shift in mindset is demonstrated by the small caps outperforming the large caps in the last quarter for the first time in a while (small caps are perceived to be riskier and are far more sensitive to retail investor moves). In addition term deposit growth has slowed dramatically, indicating a move by investors to allocate more cash to areas like the share market or property. The chart below illustrates the movement in term deposits.



Source: Bell Potter

Resources

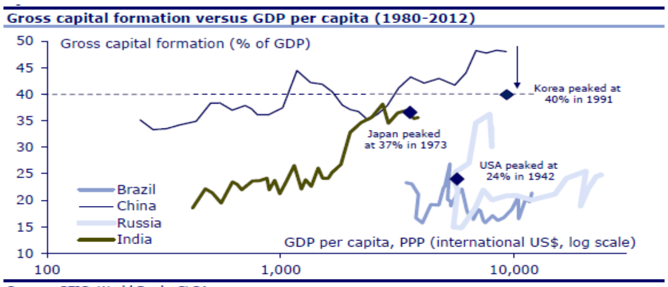
The small cap resource sector suffered a severe beating last year. We decided to investigate whether some value had emerged in the heavily hit sector and were pleasantly surprised to find a few small resource companies with world leading cost structures that seemed priced for a doomsday scenario. The Fund put its toe in the water in this space with about 3% of the Fund now exposed across 3 junior resource companies.

We believe that the time was well spent as it identified a few interesting opportunities that we can pursue with more vigour once a full capitulation in the resource space takes place (which we anticipate will occur within the next few years).

In addition, the exercise reminded us of some of the more frightening factors that continue to support our bearish view on many commodities over the medium term and continued underweight position in the sector. Some of the more noteworthy observations are listed to the right:

- China consumes the following share of the world's resource production with only 20% of the world's population:
  - Copper 40%
  - Thermal coal 50%
  - Iron Ore 60%

  We are not convinced by the urbanisation argument that anticipates even further expansion in the share of those commodities going to China – at 48%, China's investment spend to GDP is already significantly higher than for any other large industrialising country in history as illustrated by the chart below (courtesy CLSA).



Source: CEIC, World Bank, CLSA

  Significant recent supply additions add to our concern over the sustainability of China's commodity intake.

- Australia's cost of producing thermal coal, at $80 per tonne (compared to South Africa's $50/tonne), is amongst the highest in the world and currently above prevailing spot (selling) prices. China could move from net coal importer to exporter within the next few years due to rising coal production in China combined with moves to reduce coal consumption for environmental reasons. Australia's second biggest export is therefore under severe threat.

In summary:

Risk appetite has increased (albeit from a low base) and although further improvement is possible we believe additional caution is now merited.

We believe fundamentals for commodities are worse than current investor sentiment and are awaiting a final purge before venturing much further into the space. We fear that the outgoing tide may become too strong for even the strongest swimmer (modified Buffett quote)**.**

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

Contact Details

Trustee and Investment Manager	Web	www.jencay.com.au	
	Tel	+61 2 9238 6177 +61 415 233 512	
	Email	info@jencay.com.au	
Administrator	Tel	+61 2 8262 2800	White Outsourcing Pty Ltd Level 3, 99 Bathurst Street Sydney NSW 2000
	Fax	+61 2 9221 1194	
	Email	registry@whiteoutsourcing.com.au	

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