JENCAY capital

AFS Licence Number 402024
ACN 148810413

Jencay Australia Investment Fund

Quarterly report – 30 September 2014

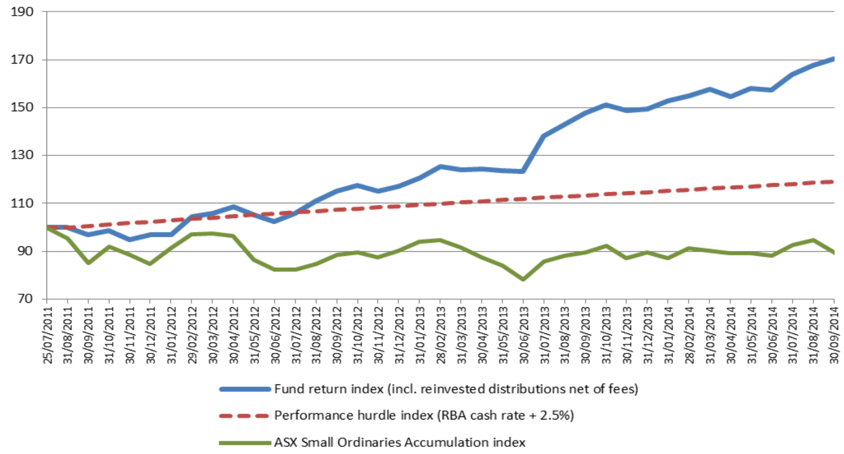
Performance

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	**18.2%**	**15.2%**	**8.1%**
Performance hurdle (RBA cash rate + 2.5%)	5.6%	5.1%	1.3%
ASX Small Ordinaries Accumulation Index	(3.4%)	(0.1%)	1.5%

Unit Price

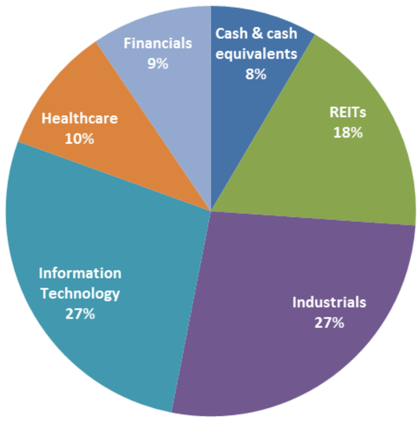
NAV per unit		**AUD 1.5436**
Application price	(0.5% spread added)	AUD 1.5513
Redemption price	(0.5% spread deducted)	AUD 1.5359

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 17.5m**

The fund was up 8% for the quarter in comparison to a 1.5% return for the ASX Small Ordinaries Index and a flat result for the ASX All Ordinaries Index. Small caps outperformed large caps, which was a welcome change. Enero slipped out of the top 10, to be replaced by Galileo Japan Trust, a former top 10 position. The Fund's weighting to REITs declined from 21% to 18% after Astro Japan Property Trust was sold and Folkestone Education Trust was trimmed following a strong performance. The AUD declined fairly sharply during the quarter which assisted fund performance.

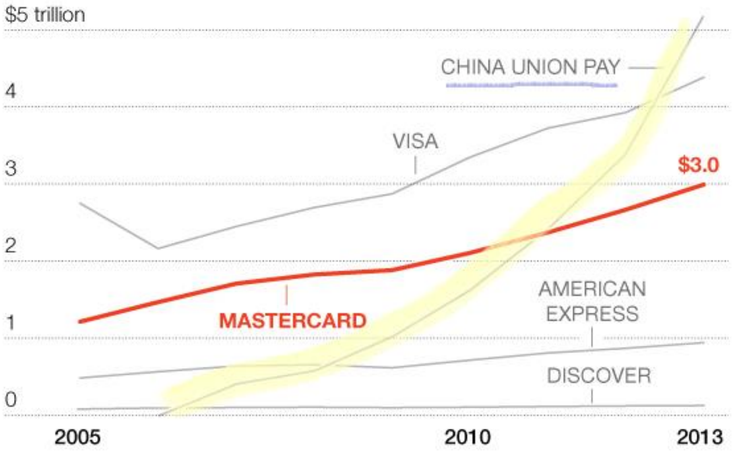
Top 10 Positions

Weight %	Name	Summary Investment Case
8	**Cash & cash equivalents**	Approximately 2/3rds 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.
5	**Mirvac Industrial Trust**	Just prior to quarter end a firm offer for MIX units at a small premium to its net tangible asset value was received, following an expression of interest campaign. The unit price is trading close to the offer price and should crystalize into cash in the current quarter.
5	**Thinksmart**	Provider of consumer credit via leading electronics and other retailers. After the recent sale of their challenged Australian business, the group is now focused exclusively on its attractive and growing UK business. With available cash of $30m to pursue UK growth, the business, which should generate circa $8m in PBT, is being valued at about $25m (a ridiculously cheap 3x).
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. 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 onerous grape supply contracts. Despite the improving outlook, it trades on a P/E of less than 8x expected 2015 earnings. Reasonably high debt is a risk.
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 almost tripled since we initiated a position 18 months year ago. It now trades on a prospective EV/EBITA multiple of 12x which is still modest for a market leader with entrenched client positioning and strong growth prospects.
5	**Servcorp**	Market leader and world's second biggest serviced office business behind Regus, with the founder and CEO owning 50%. $1/5^{th}$ 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. Despite a strong share price run it is valued at only 10x 2015 expected EBIT - attractive for a quality company with good management and a large portion of earnings generated outside Australia.
5	**Austal**	The world's leading aluminium ship builder with significant, long term US Navy contracts in addition to its commercial sales and Australian and other military sales. Although we have enjoyed a strong share price performance from Austal, it is still being valued on a low multiple of future earnings (<10x).
5	**Reckson New York Property Trust**	Real Estate Investment Trust (REIT) holding suburban office property in the New York tri-state area. Although RNY is taking longer to improve occupancy than we expected, the share price is less than 60% of RNY's NTA (net tangible asset value), indicating limited downside but still substantial upside if portfolio occupancy improves and/or the AUD declines further.
4	**Pro Medicus**	Radiology software for practice management and remote image viewing. The company historically enjoyed strong market share in Australia but due to a confluence of events has endured a lean few years. An astute acquisition during the GFC and significant R&D has elevated the company's viewing platform to the leading product globally. With 3 large US client wins under its belt in the last 12 months, PME is set for strong growth. At the current share price, the upside from any additional client wins appears to be free.
4	**Galileo Japan Trust**	REIT holding office, retail and residential property in Japan, primarily Tokyo. It is currently trading at 3/4 of NTA and on a (tax deferred) distribution yield exceeding 8%. It appears that the Japanese property cycle has bottomed with evidence that rentals and valuations are starting to improve. In contrast to GJT, Japanese domiciled REITS are currently trading above NTA.

What the……..?

Each quarter, we attempt to share an interesting insight or observation we've made in the course of our research. We hope the following chart fits the bill:

Purchase volume by Card brand, *in US$ trillions*



The chart which was brought to our attention by CLSA and sourced from a 24 July Fortune article using Nilson data, elicited from me the response used in the title on the top of the page. The immediate questions that came to mind were:

1. ***How is it possible that the Chinese Card brand could have overtaken the two global card giants, Visa and Mastercard, in terms of transaction value, in less than 10 years from starting out?***
2. ***Is this another ominous sign for China?***
3. ***Does the chart call into question the sustainability of China's consumption?*** *The sustainability of China's capital investment spending has been called into question by many commentators but a potential drop in consumption spending has very rarely been highlighted as a risk.*

Unfortunately we are not able to answer the questions adequately because China Union Pay cards (the dominant card brand in China) are used not only for traditional card purchases but also for automobiles and houses, which is not the case with other cards, and therefore not completely comparable.

Nevertheless the following statistics put in context the enormity of over $5 trillion dollars of spending on debit/credit cards in a single year:

- *China's entire 2013 GDP was $9.2 trillion comprising:*
    - $3.3t of Household Consumption
    - $1.3t of Government Consumption
    - $4.2t of Gross Capital Formation (Investment spend)
    - $0.3t of net exports
- *Chinese annual imports are roughly $1.8t and exports $2.1t*

Spending on China Union cards is therefore more than half of Chinese GDP and almost triple its imports. It exceeds Household and Government Consumption spending combined.

When it comes to China, there are many statistics that simply beggar belief. Very few would argue the status quo is healthy or sustainable but most commentators seem to take comfort from the view that the cliff is not yet in sight and "continue to dance, while the music plays". This is reminiscent of the sentiment before the GFC. Just ask Chuck Prince, ex-CEO of Citigroup, how helpful that view was in retrospect.

When we buy a stock, we take a long term view and try to answer the question: "would we be happy to hold this stock for 10 years if liquidity in the market or stock dried up?" Although our view can change, that question is very helpful in avoiding potential cliffs. It also results in remarkable stability in the composition of the portfolio with very little variation from month to month.

While a few bumps in the road are inevitable, focusing on the long-term should help us to avoid the cliff of permanent capital loss. Reduced tax and trading costs are an added benefit of such a strategy.

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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