JENCAY capital

AFS Licence Number 402024
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Jencay Australia Investment Fund

Quarterly report – 31 December 2012

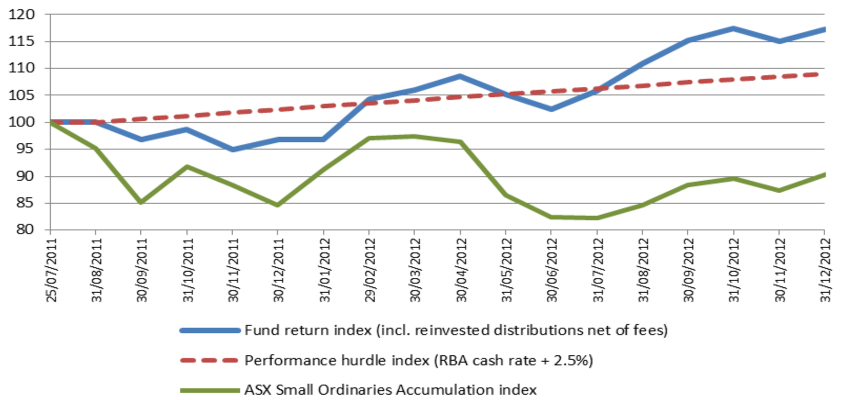
Performance

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	**11.7%**	**21.1%**	**1.8%**
Performance hurdle (RBA cash rate + 2.5%)	6.1%	6.4%	1.4%
ASX Small Ordinaries Accumulation Index	(9.8%)	6.6%	2.0%

Unit Price

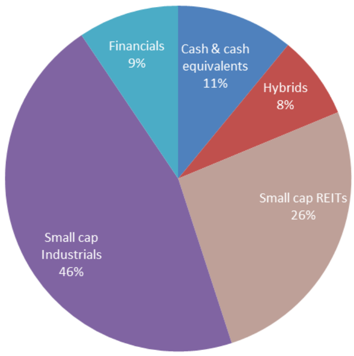
NAV per unit		**AUD 1.1334**
Application price	(0.5% spread added)	AUD 1.1391
Redemption price	(0.5% spread deducted)	AUD 1.1277

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 7.9m

Australian large caps had a strong quarter with the ASX All Ordinaries Index bouncing 7%. Small caps were more subdued with a 2% gain for the ASX Small Ordinaries Index, which was in line with the Jencay Australia Investment Fund quarterly return. Australian Education Trust re-entered the top 10 positions as a result of strong share price growth. Austal, the disappointment for the quarter due to a heavily discounted rights issue, also re-entered the top 10 after the Fund took up a multiple of its entitlement in the capital raising. A new stock, Thinksmart, which is described below, has entered the top 10 for the first time. The 3 stocks that exited the top 10 were Fisher and Paykel (following completion of its takeover), Mirvac Industrial Trust and Clearview (both of which have not been sold). We continue to find compelling investment opportunities in the largely ignored small cap space which should produce strong risk adjusted returns over the medium to long term.

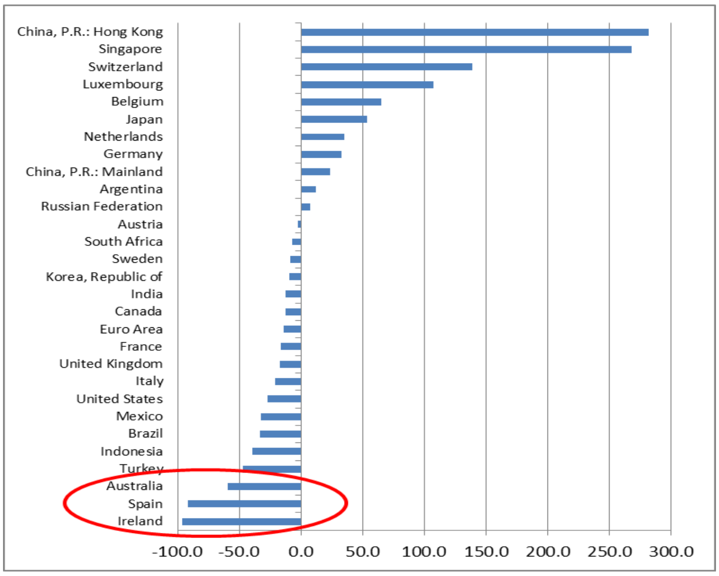
Top 10 Positions

Weight %	Name	Summary Investment Case
11	**Cash & cash equivalents**	Just over half 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	**Multiplex European Property Trust**	The share price is approximately 80% of the trust's unencumbered cash holdings. Although the underlying German retail property portfolio is 100% geared at current valuations, the portfolio produces positive free cash flow (which is being retained to pay down property portfolio debt) and could have value in the future (hence a free option on any recovery).
7	**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 half of its Net Tangible Asset value (NTA) and on a forward earnings yield of circa 20%. The trust has successfully refinanced most of its debt and the markets in which the properties are located seem to have bottomed. We are anticipating the resumption of distributions shortly.
7	**Servcorp**	Market leader and world's second biggest serviced office business behind Regus. Founder and CEO owns 50%. 1/3rd 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. Servcorp has strong long term growth potential and a large portion of earnings are generated outside Australia.
6	**Integrated Research**	Global leader in performance monitoring and diagnostics software for business critical IT infrastructure with 8 of the world's 10 biggest companies using their software. With 95% of revenue generated outside Australia and 50% of costs AUD based, profits are leveraged to AUD:USD movements. The price has doubled since initial purchase and although now closer to fair value, it is on a dividend yield above 4% (effectively in USD) and still growing strongly.
6	**Austal**	The world's leading aluminium boat builder. It has secured two US Navy contracts to produce 20 ships that will keep Austal's US facility in full production to 2018. Austal recently completed a large, discounted rights issue to reduce debt, which had a negative impact on fund performance for the quarter. The fund took up a multiple of its entitlements, as we believe the offer was priced at a big discount to fair value (Enterprise Value 4x projected EBIT for 2014).
5	**Salmat**	Australia's leading provider of one-to-one communications including online and physical catalogue distribution, contact centres and digital communication. Founders hold 40%. Salmat recently sold its most challenged division, Business Process Outsourcing, and as a result is in a position to pay a large fully franked dividend and settle all its debt. Despite solid growth prospects and excellent cash generation, we calculate that the stock is trading on an attractive EV/EBIT multiple of 7x when we adjust for the sold division.
5	**Thinksmart**	Provider of consumer credit via partners including Dixons in the UK and JB Hifi and Dick Smith in Australia. 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 for profits, Thinksmart's stock price has dropped below its NTA despite some exciting new products and growth initiatives. The accounting change produces a short-term hit to 2012 accounting earnings but if growth comes through as we expect the stock is trading on a P/E of less than 3x 2014 projected earnings.
5	**Elders (Hybrid and Ordinary)**	The group has put all its businesses up for sale. The hybrid (perpetual preference shares) price is 40% of face value and ordinary share price 1/3rd of NTA despite management's expectations of sales proceeds in excess of tangible asset value and well in excess of the current market valuation.
5	**Australian Education Trust**	REIT owning 333 childcare centres spread throughout Australia which it rents out on triple net leases with 10 year term remaining. At the current share price its 2014 expected distribution yield exceeds 9% which we expect to grow at least in line with inflation.

Will Australia be a repeat of Spain and Ireland?

In 2007 both Ireland and Spain were considered to be strong economies with low government debt and robust growth. How quickly things have changed. Today Australia, with high growth relative to most developed countries and low government debt, is considered a safe haven. Unfortunately Australia shares many of the vulnerabilities of Spain and Ireland, as discussed below:

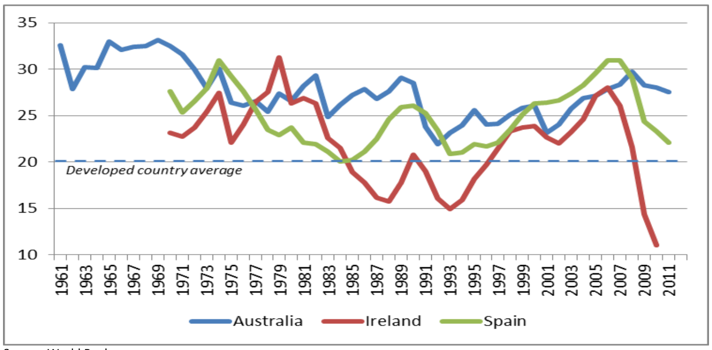
Australia has incurred 30 years of continuous current account deficits (imports exceeding exports). The accumulated deficits have resulted in significant net foreign liabilities for Australia. The chart below compares **Net International Investment position as % of GDP** (foreign assets less foreign liabilities) for 29 countries:



Source: Principal Global Indicators

Australia's Net foreign liability position is exceeded only by Spain and Ireland. High levels of net foreign liabilities render a country particularly vulnerable when economies deteriorate, as foreign lenders can be extremely fickle.

Although **Gross Fixed Capital Formation** (Investment spend for a country) averages around 20% of GDP for developed countries, construction bubbles pushed Spain above 30% and Ireland above 28% in 2006 (see chart below).



Source: World Bank

The subsequent severe drop off has been a key driver of job losses and recession in Ireland and Spain. Australia has been sitting above 25% since 2003 (and indeed above 20% for the last 50 years) due to buoyant commercial and residential construction until 2008 and subsequent bubble in mining and gas investment. A reduction of investment spend could be very painful for Australia just as it has been for Spain and Ireland.

Many argue that Australia's low **Government Debt to GDP** (27%) will shield it, however Spain's modest 41% in 2007 now exceeds 80% and Ireland with a low 28% in 2007 has now exceeded 110%.

Another concerning similarity is the high level of **household debt** that all three countries share. Australia's household debt is amongst the highest in the world relative to disposable income and GDP.

We have attempted to position the Fund with Australia's vulnerabilities, described above, in mind. As a consequence we are avoiding companies with high leverage as well as sectors that have benefitted over the last few years like resources, banking and construction and have instead taken positions in more defensive companies and those exposed to significant foreign currency earnings.

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 by buying securities trading significantly below fair value (bargains). Cash will be held on deposit when bargains are not available in the market. The fund will have 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
Investment restrictions	▪ Maximum of 40 individual security holdings ▪ 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

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