JENCAY
capital

AFS Licence Number 402024
ACN 148810413

Jencay Australia Investment Fund

Quarterly report - June 2012

Performance

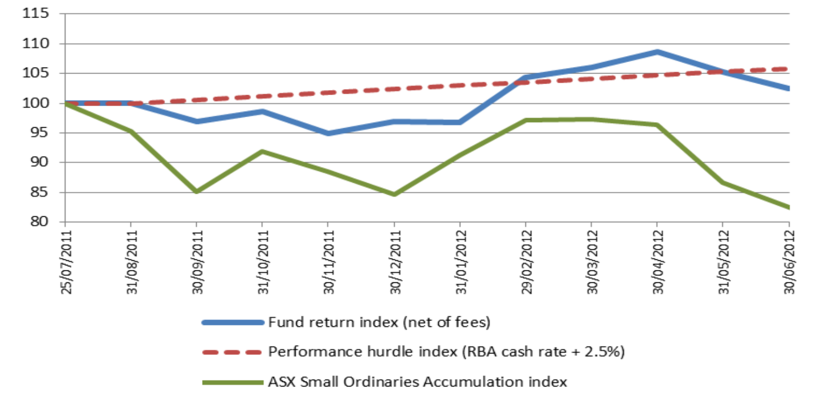
Returns are net of fees, exclude buy/sell spreads, assume reinvestment of distributions/income and are not annualised	Since inception (25 July 2011)	Quarter to 30 June 2012
Fund total return	**2.42%**	**(3.40%)**
Performance hurdle (RBA cash rate + 2.5%)	5.78%	1.59%
ASX Small Ordinaries Accumulation Index return	(17.55%)	(15.30%)

Unit Price at 30 June 2012

	Cum*	Ex*
NAV per unit	**AUD 1.0242**	**AUD 0.9895**
Application price		AUD 0.9945
Redemption price		AUD 0.9846

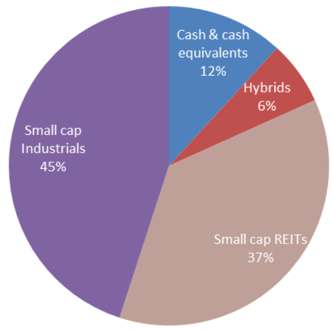
* The Cum price is inclusive of the **3.47c** June distribution. The Ex price is net of the distribution.

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. Although inception date was 25 July 2011, fees only started accruing from 1 September 2011.

Fund Composition



Fund size : AUD 6.0m

The June quarter was very tough for equities and small caps in particular. The ASX All Ordinaries index dropped 6% and the Small Ordinaries index dropped 15%. The Jencay Australia Investment Fund (the Fund) was down a more moderate 3.4% for reasons discussed on page 2, “Thoughts on the portfolio”. Two new stocks, Multiplex European Property Trust and Integrated Research (descriptions included below), entered the Top 10 Positions at the expense of Paperlinx and Salmat which still occupy positions in the Fund just outside of the top 10. As the market softened over the quarter, the Fund’s exposure to equities was increased with the Fund’s cash holding reducing from 18% to 12%.

Top 10 Positions

Weight %	Name	Summary Investment Case
12	**Cash & cash equivalents**	Half the cash is on call deposit with the custodian, JP Morgan and is denominated in AUD. The other half is held in an ASX listed exchange traded fund whose only asset is a USD call deposit with JP Morgan.
7	**Servcorp**	World’s second biggest serviced office business behind Regus, but is considered the market leader. Founder and CEO owns 50%. 1/3rd of its market cap is backed by cash with no debt. Enterprise value is approximately 3 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	**Multiplex European Property Trust**	The share price of 7.5c is less than 2/3rds of the trust’s unencumbered 12c 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 repay property portfolio debt) and could have value in the future (hence a free option on any recovery).
6	**Reckson New York Property**	Real Estate Investment Trust (REIT) holding suburban office property in the New York tri-state area. The share price is 1/3rd of its Net Tangible Asset value (NTA) and on a forward earnings yield of 20%. The trust has successfully refinanced most of its debt and the markets in which the properties are located seem to have bottomed.
5	**Elders (Hybrid and Ordinary)**	2nd biggest farm supply and service network in Australia and one of Australia’s oldest businesses. After near death due to excessive debt and a failed conglomerate strategy, Elders, under new management, has sold businesses, substantially reduced debt and seems to be on a sustainable path. Nevertheless, the hybrid (perpetual preference shares) price is 1/3rd of face value with our expectation that hybrid distributions will resume in 2014 (25% forward yield). The ordinary share is trading at less than half its NTA on a forward P/E below 5x.
5	**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. The expected free cash flows from those 2 contracts alone exceed Austal’s current enterprise value. This means that any additional earnings generated from servicing the delivered Navy ships; their currently underutilised Australian and Philippine production facilities; and any earnings generated post 2018 are free at the current share price.
5	**Fisher and Paykel Appliances**	Appliance manufacturer with dominant market share in New Zealand and No.2 in Australia as well as a presence in North America, Europe and Asia. It also has one of the top consumer finance businesses in New Zealand. The company has been responsible for many of the world’s appliance innovations over the last decade however the stock price is less than its NTA, on a forward P/E of 7x despite earnings being at cyclical lows and the company having strong growth prospects.
5	**Astro Japan Property**	REIT holding retail and office properties in Japan. The share price is half of its NTA, on a forward earnings yield of 20%. 60% of earnings are being retained to amortise debt (gearing 60%) which should grow earnings and NTA going forward. Japanese office rentals seem to be close to bottom of cycle.
5	**Mirvac Industrial Trust**	REIT holding warehouse property in Chicago. Debt has been refinanced on a long term basis. The share price is approximately half of NTA and on an underlying earnings yield of circa 20%. The cycle seems to have bottomed with our expectation that valuations, rentals and occupancy will improve going forward. Any A$ weakness will also be beneficial.
5	**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. We believe its forward P/E of 12x is too low for a quality, debt free, cash generative business that is still growing strongly and paying high dividends (2012 expected dividend yield greater than 7%).

Thoughts on the portfolio……

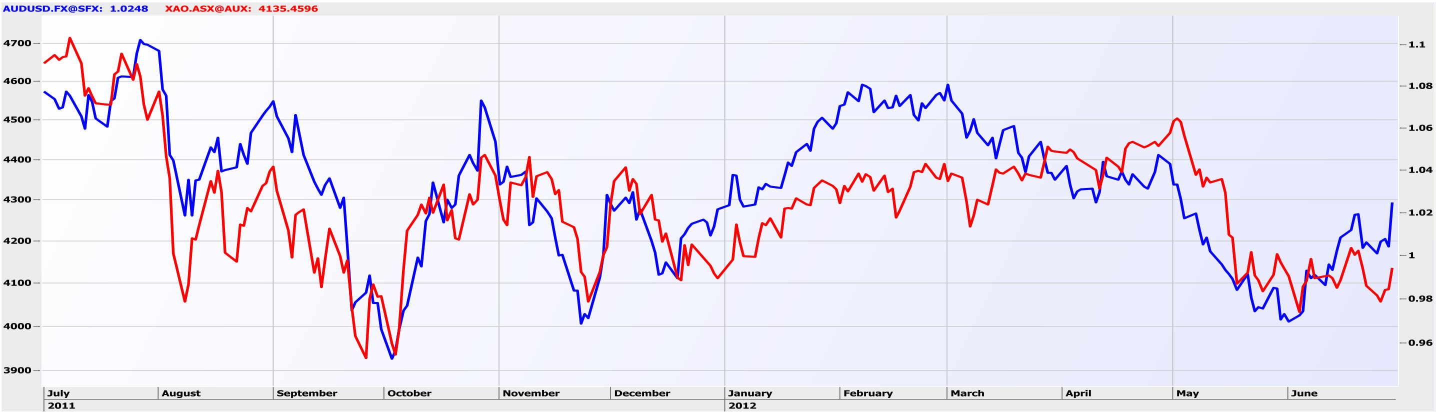
There is a common perception that small caps are more volatile and more risky than the overall market. It may therefore come as a surprise that this small cap focused fund has generally dropped less than the overall market on down days. How has the Fund managed to achieve this reduced volatility?

We believe there are four main reasons:

1. *Although small caps as a group are more volatile than large caps, some small caps are very stable and defensive. Many of the small caps held by the Fund exhibit lower volatility and have low Beta's.*
2. *The Fund has no exposure to the resource space which is generally more volatile and which has significantly underperformed over the last year.*
3. *The Fund has a large exposure to stocks with non-Australian dollar denominated earnings and approximately half the Fund's cash is in USD. Overall the Fund is more than 50% exposed outside the AUD.*
4. *To the extent the Fund holds companies that are mainly domestic AUD earners, we have a bias toward defensive, less economically sensitive stocks or companies emerging from a trough. We believe Australia's economy is vulnerable and although we cannot be certain that Australia's economy will weaken further, holding bargain priced defensive stocks should hold us in good stead under most scenarios.*

The chart below illustrates how closely movements in the AUD:USD exchange rate (blue line) have mirrored movements in the Australian share market (as represented by the All Ordinaries Index, red line). The AUD is closely correlated with general investor sentiment. When sentiment is bullish, risk appetite increases and the AUD generally rallies. Conversely when sentiment turns bearish, risk appetite reduces, the AUD tends to dip and stocks with non AUD earnings hold up better as their earnings are now worth more in AUD terms. This relationship has helped the Fund, when the market has dipped, due to its large exposure to foreign earnings.

A potential danger, in focusing on the downside, especially when the market is already depressed, is missing out on a strong rally when sentiment improves. In this regard we believe the Fund is positioned to capture the majority of the upside due to our large equity allocation (which we increased to close to 90% over the quarter) and strict adherence to our investment strategy of only buying stocks at prices well below fair value i.e. bargains. We would therefore like to think of the Fund as defensive but capable of generating strong returns when sentiment improves. Whilst we cannot guarantee reduced volatility at all times, our aim is for the Fund's future track record to continue as it started and over the long term to produce higher returns than the overall market with lower risk.



Source: Iress

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 buy 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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