JENCAY capital

AFS Licence Number 402024
ACN 148810413

Jencay Australia Investment Fund

Quarterly report – 31 March 2013

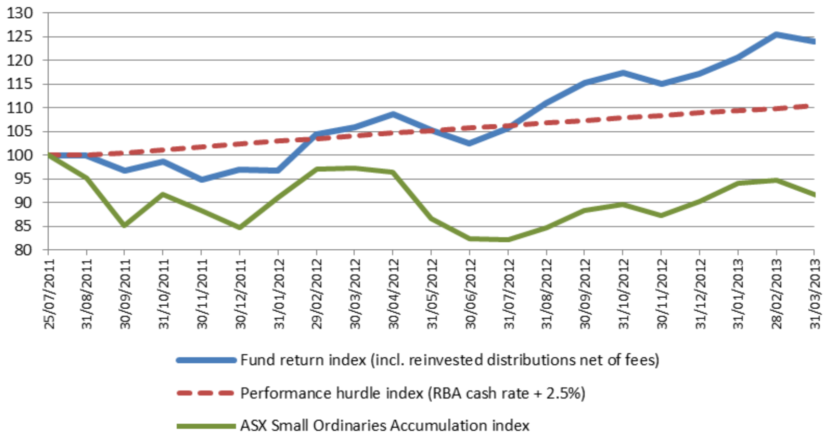
Performance

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	**13.6%**	**17.0%**	**5.7%**
Performance hurdle (RBA cash rate + 2.5%)	6.1%	6.0%	1.4%
ASX Small Ordinaries Accumulation Index	(5.0%)	(5.8%)	1.6%

Unit Price

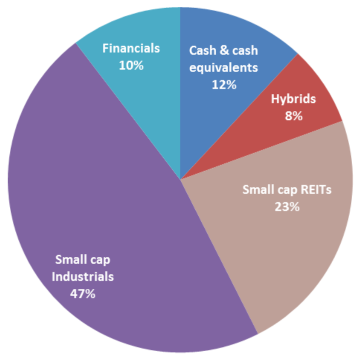
NAV per unit		**AUD 1.1982**
Application price	(0.5% spread added)	AUD 1.2042
Redemption price	(0.5% spread deducted)	AUD 1.1922

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 8.9m

During the quarter, Australian large caps continued to race ahead of small caps with the ASX All Ordinaries up 8% versus a 1.6% gain for the ASX Small Ordinaries Index. The Jencay Australia Investment Fund's 5.7% return for the quarter was satisfactory especially relative to the subdued small caps. Integrated Research and Salmat slipped out of the top 10 fund positions in favour of Mirvac Industrial Trust (a previous top 10 position) and a new addition, Enero, which is described below. Large cap valuations look decidedly stretched but amongst small caps, compelling value still exists given their underperformance, which explains the Fund's continued low cash levels/high equity allocation. We will delve into the large cap/small cap divergence in more detail overleaf.

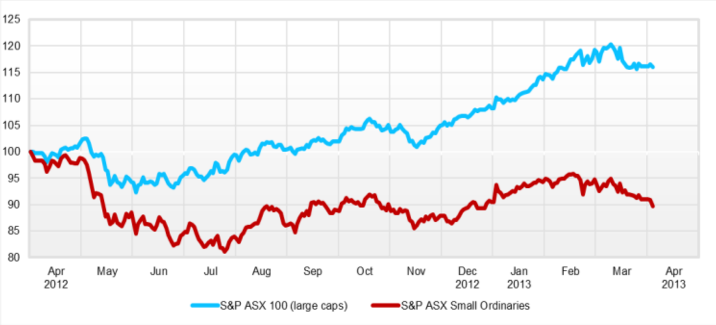
Top 10 Positions

Weight %	Name	Summary Investment Case
12	**Cash & cash equivalents**	Approximately 2/3rds 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	**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 in just over a year, it still looks very cheap based on a share price that is approximately half of its Net Tangible Asset value (NTA), the expectation of some recovery in the underlying property markets and the imminent completion of its last remaining debt refinancing.
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 stock is up 50% since we initiated our position in mid-2012, we believe it still offers good upside, based on a P/E of less than 5x 2014 projected earnings.
6	**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. 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 is approximately 80% of the trust's unencumbered cash holdings. Although the underlying German retail property portfolio is over 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).
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. Following a large rights issue Austal's debt levels seem manageable. Attractive upside potential based on an Enterprise Value of 5x our estimate of EBIT in 3 years' time.
5	**Enero**	Enero, an owner of marketing services businesses including PR and creative agencies, previously operated under the name Photon. Photon embarked on an aggressive debt fuelled acquisition spree that almost bankrupted the company. A large portion of the acquired businesses were sold to repay its debt. Enero now has net cash on its balance sheet equivalent to half of its market cap. 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. With the current share price equivalent to the company's NTA (comprising cash and working capital), effectively all IP and future profits are free.
5	**Australian Education Trust**	REIT owning 333 childcare centres spread throughout Australia which it rents out on triple net leases with 9 year term remaining. Although the Fund has enjoyed strong share price growth from AEU, its 2014 expected distribution yield exceeds 8% which we expect to grow at least in line with inflation thereafter.
4	**Mirvac Industrial Trust**	REIT holding warehouse property in Chicago. Debt has been refinanced on a long term basis. The share price is approximately 2/3rds of NTA and on an underlying earnings yield of circa 15% with distributions set to resume imminently. 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.
4	**Elders (Hybrid and Ordinary)**	The group has put all its businesses up for sale. The hybrid (perpetual preference shares) price is 1/3[rd] of face value and ordinary share price 1/3[rd] of NTA despite management's expectations of sales proceeds in excess of tangible asset value and well in excess of the current market valuation.

Recent market trends

During the last couple of quarters interesting market developments have taken place which we believe are worth highlighting, especially in view of some clients asking whether it is still a good time to invest:

1. Small Cap and Large Cap divergence



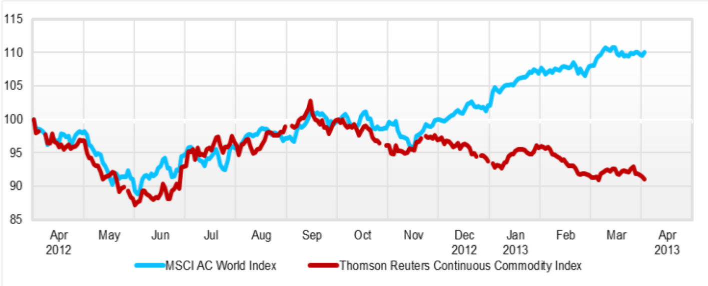
Source: Factset (both series use a common base of 100)

As illustrated above, small caps have massively lagged the significant bounce in the overall market. Over the past year, the large cap index is up over 15% in comparison to a 10% drop for the small cap index (S&P ASX Small Ordinaries Index).

Why have small caps lagged so much?
Firstly, the small cap index has a different composition to the large cap index, most notable of which is the absence of banks in the small cap index. With banks making up almost 30% of the large cap index, their **50%** rise since June, driven by a search for high dividend yield and perceived safety, has been the biggest contributor to large cap outperformance.
Secondly, whilst institutional and foreign money seems to have flowed into the large cap space, retail investors, who are a bigger driver amongst small caps have yet to re-enter the market in a material way.

Will small caps continue to underperform large caps?
Historically, when measured over long periods, small caps have actually marginally outperformed large caps. Once retail investors rediscover their appetite for equities or if institutions allocate additional funds to the small cap sector, we believe the gap will start to close. With bank valuations now looking stretched and small cap valuations looking far more appetising than large cap valuations, we believe investors will do better in small caps than large caps over the medium term. Good stock picking in the small cap space should provide further benefit.

2. Commodities have begun to diverge from stock market returns



Source: Factset (both series use a common base of 100)

Following a decade of outperformance by commodities, they have not followed the recent stock market rally, as illustrated by the chart above. Opinion varies on the reasons for this divergence but we believe two explanations stand out:

Firstly, China's steel consumption seems to have flattened at the same time that iron ore supply is increasing. The same can be said for copper and other metals.

Secondly, we subscribe to the opinion of some leading economists that global money supply has begun a period of more subdued growth notwithstanding the quantitative easing by US and European central banks. With money supply stalling, a consequence is weak commodity prices in contrast to the last decade when rampant money supply growth contributed to booming commodity prices. Avoiding resource stocks has served the Fund well to date, helping to offset some of the underperformance from not holding banks.

In summary, we believe that although a portion of the rally is behind us, the Fund is well positioned to outperform the stretched large caps over the <u>medium term</u>. Short term movements are far harder to predict.

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

Contact Details

Trustee and Investment Manager	Web Tel Email	www.jencay.com.au +61 2 9238 6177 +61 415 233 512 info@jencay.com.au	Jencay Capital Pty Ltd Level 57 MLC Centre 19-29 Martin Place Sydney NSW 2000
Administrator	Tel Fax Email	+61 2 8236 7701 +61 2 9221 1194 registry@whiteoutsourcing.com.au	White Outsourcing Pty Ltd Level 7, 20 Hunter Street Sydney NSW 2000

Disclaimer