JENCAY
capital

AFS Licence Number 402024
ACN 148810413

Jencay Australia Investment Fund

Quarterly report – 30 September 2012

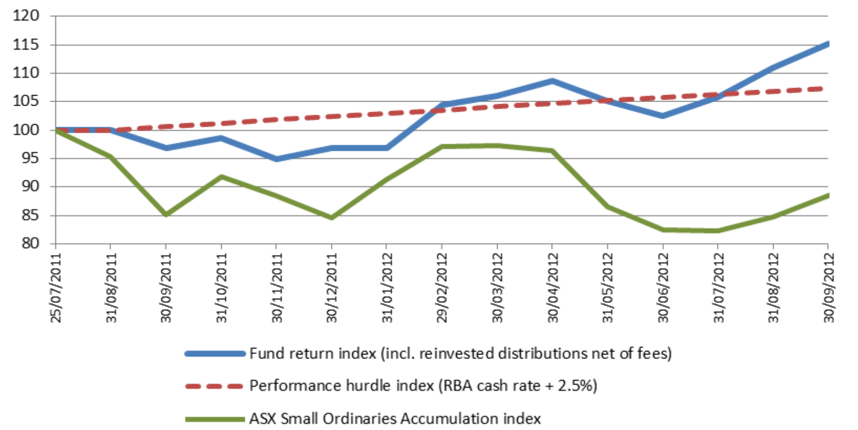
Performance

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	**12.7%**	**19.0%**	**12.5%**
Performance hurdle (RBA cash rate + 2.5%)	6.2%	6.8%	1.5%
ASX Small Ordinaries Accumulation Index	(9.9%)	3.8%	7.3%

Unit Price

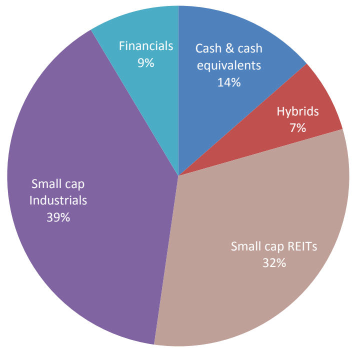
NAV per unit		**AUD 1.1134**
Application price	(0.5% spread added)	AUD 1.1189
Redemption price	(0.5% spread deducted)	AUD 1.1078

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 7.3m

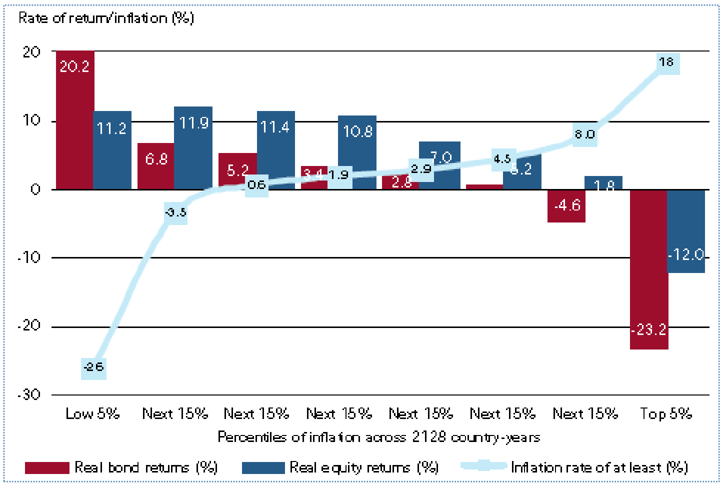
The Jencay Australia Investment Fund achieved a pleasing 12.5% return for the quarter in comparison to index returns of 7% for both the ASX All Ordinaries and ASX Small Ordinaries. The Fund benefitted from takeover approaches for both Clearview and Fisher and Paykel and also enjoyed a very strong performance by Integrated Research following their full year result announcement. Clearview and Salmat re-entered the top 10 at the expense of Astro Japan and Austal which still occupy substantial positions in the Fund.

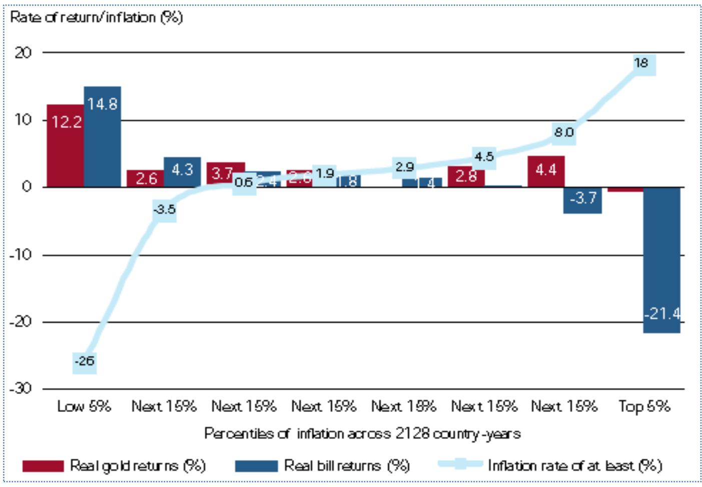
Top 10 Positions

Weight %	Name	Summary Investment Case
14	**Cash & cash equivalents**	Approximately 2/3rds of the cash is on call deposit with the custodian, JP Morgan and is denominated in AUD. The remaining 1/3rd is held in an ASX listed exchange traded fund whose only asset is a USD call deposit with JP Morgan.
7	**Fisher and Paykel Appliances**	The New Zealand based appliance manufacturer is under takeover offer from Haier of China. The position should therefore convert to cash shortly.
7	**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 almost doubled over the quarter and although now closer to fair value, it is on a dividend yield above 4% (effectively in USD) and still growing strongly.
6	**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 3.5 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. It recently embarked on a share buy-back.
6	**Multiplex European Property Trust**	The share price is less than 3/4 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).
6	**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 40% of face value with our expectation that hybrid distributions will resume in 2014 (20% forward yield). The ordinary share is trading at less than half its Net Tangible Asset value (NTA) on a forward P/E below 5x.
5	**Reckson New York Property**	Real Estate Investment Trust (REIT) holding suburban office property in the New York tri-state area. The share price is approximately 40% of its 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.
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 the group's growth prospects and excellent cash flows, we calculate that it is trading on an attractive EV/EBITA multiple of 6x when we adjust for the sold division.
5	**Mirvac Industrial Trust**	REIT holding warehouse property in Chicago. Debt has been refinanced on a long term basis. The share price is approximately 60% of NTA and on an underlying earnings yield of circa 20% with distributions expected to resume within the next year. 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	**Clearview**	A young, innovative, life and wealth management business with top management and an impressive product distribution network that has the potential to multiply market share from its current low base. Although it is under takeover, we believe the offer, at just above NTA, significantly understates fair value.

Inflation/Deflation and Real Returns

With the reintroduction of quantitative easing in the US, Europe and Japan, the inflation versus deflation debate is raging again. An excellent analysis of the historical relationship between inflation/deflation and real investment returns, was contained in the 2012 Credit Suisse Global Investment Returns Yearbook. The charts below, which were extracted from the Yearbook, were compiled using data for 19 countries, all with 112 year investment histories dating from 1900 to 2011 and compare real investment returns with inflation in the same year. Average returns are calculated for each group with groups split based on percentiles of inflation with the "Low 5%" group capturing <u>deflation</u> observations ranging between (3.5%) and (26%) and the "Top 5%" group capturing <u>inflation</u> observations of 18% or more.





We find the above charts extremely illuminating. Some of our personal observations are listed below (please note observations are based on the group averages and will not apply in every individual case):

- *Surprisingly, deflation has been good for all asset classes, whilst inflation has been bad (Japan therefore seems to be an outlier, possibly due to a bubble equity market marking the starting point of their deflationary period).*
- *Bond returns have exceeded equity returns <u>only</u> under severe deflationary conditions, on average (recent experience is therefore contrary to historical averages).*
- *<u>Only</u> under conditions of very high inflation has Gold outperformed Equities by a significant margin. Gold does seem to be the only asset class that has provided some protection in times of severe inflation.*

112 years of history seems to suggest that equities perform well under most conditions (even deflation). We aim to improve the position even further, for investors in the Fund, by buying equities only when they are at bargain prices with a view to realising attractive risk-adjusted real returns over the long term.

Fund Key Features

Comprehensive Terms are contained in the Information Memorandum which can be downloaded from the website <u>www.jencay.com.au</u> 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	<u>www.jencay.com.au</u> +61 2 9238 6177 +61 415 233 512 <u>info@jencay.com.au</u>	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 <u>registry@whiteoutsourcing.com.au</u>	White Outsourcing Pty Ltd Level 7, 20 Hunter Street Sydney NSW 2000

Disclaimer