Jencay Australia Investment Fund

Quarterly report – 30 June 2015

JENCAY capital
AFS Licence Number 402024
ACN 148810413

Performance

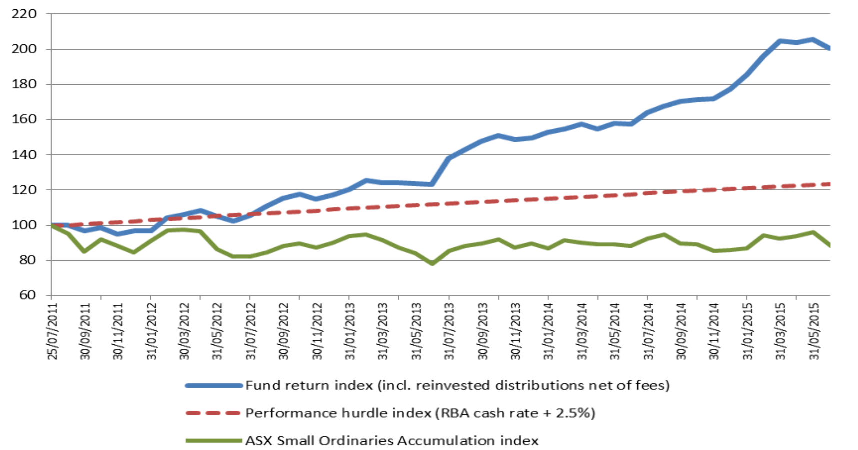
Returns are net of fees, exclude buy/sell spreads and assume reinvestment of distributions/income	Since inception (annualised)	Latest 12 months	Latest Quarter
Fund total return	**19.4%**	**27.5%**	**(1.9%)**
Performance hurdle (RBA cash rate + 2.5%)	5.5%	5.0%	1.2%
ASX Small Ordinaries Accumulation Index	(3.0%)	0.4%	(4.0%)

Unit Price

	Cum*	Ex*
NAV per unit	**AUD 1.820**	**AUD 1.723**
Application price		AUD 1.731
Redemption price		AUD 1.714

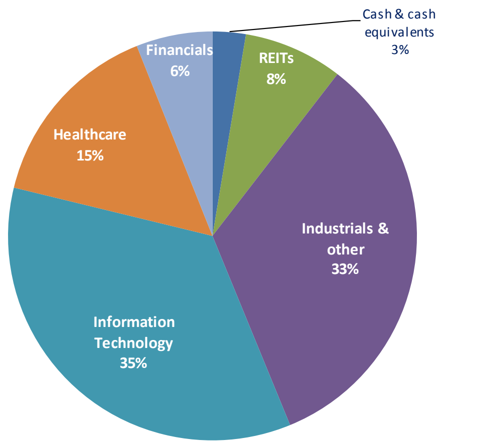
* The Cum price is inclusive of the **9.7c** June distribution. The Ex price is net of the distribution.

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



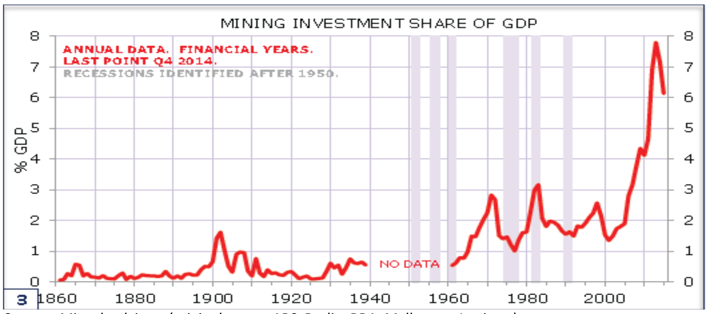
Fund size : **AUD 23.8m**

The market experienced a tough quarter with the ASX All Ordinaries Index down 6% and the ASX Small Ordinaries Index dropping 4%. The fund was down a more modest 2%. We took advantage of the weakness and ran down our cash via new investment ideas and adding to existing positions at more attractive prices. Although the cash holding at 30 June is a low 3% large inflows on 1 July have subsequently increased the cash weighting to 10%. Last quarter's newcomer, Aeris Environmental, was nudged out of the Top 10 by Netcomm Wireless which has been held in the Fund for over 18 months but entered the Top 10 for the first time following additional purchases and recent price gains (we describe the stock in further detail below). Nearmap reappears on the list.

Top 10 Positions

Weight %	Name	Summary Investment Case
7	**Pro Medicus**	Radiology software for practice management and remote image viewing. Their world leading radiology image viewing platform continued its strong growth, securing another meaningful US client this quarter, its 6th significant US client win in the last two years. Although the stock price is looking expensive based on a simple P/E ratio, it offers further upside if it continues to win more deals – very likely given its product leadership and sales traction.
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 has been a stellar performer for the fund and although upside is not as significant as it was, its share price is still below our assessed fair value based on expected revenue and profit growth.
5	**Medical Developments**	A rare example of a biotech that has been profitable since IPO 11 years ago, and not raised any capital. The company has been supplying Penthrox, an extremely effective analgesic (pain killer) in emergency medical settings in Australia for 30 years but only recently entered foreign markets. The company also has a world class asthma spacer, which is growing sales. The share price has been strong following European marketing approval and securing European distribution partners but further upside remains if they can execute appropriately.
5	**Integrated Research**	Global leader in performance monitoring and diagnostics software for business critical IT infrastructure. 5 of the world's 10 biggest companies use their software. With 95% of revenue generated outside Australia and 50% of costs AUD based, profits are leveraged to AUD:USD movements. Following strong price gains upside has reduced but we believe the valuation is still reasonable as evidenced by a dividend yield above 3% (effectively in USD) and still growing strongly.
5	**Austal**	The world's leading aluminium ship builder with significant, long term US Navy contracts in addition to its commercial and other military sales. The quarter saw Austal secure additional contracts. Although we have enjoyed a strong share price performance from Austal, it is still being valued on a low multiple of future earnings and continues to benefit from the weakening AUD.
4	**Servcorp**	Market leader and world's second biggest serviced office business behind Regus, with the founder and CEO owning 50%. 1/5th of its market cap is backed by cash, with no debt due to its prolific cash generation. The 3.5% dividend yield should grow in excess of 10% p.a. which is attractive for a quality well managed company that generates a large portion of earnings outside Australia.
4	**Thinksmart**	Provider of consumer credit via leading UK electronics retailers. With half of the company's market cap backed by cash, the business effectively trades on a P/E multiple of 4x with downside protection which is extraordinarily cheap.
4	**Galileo Japan Trust**	REIT holding office, retail and residential property in Japan, primarily Tokyo. It is currently trading below its net tangible asset value (NTA) and on a (tax deferred) distribution yield exceeding 8%. The Japanese property cycle appears to have bottomed with rentals and valuations now trending up. In contrast to GJT, Japanese domiciled REITS are currently trading significantly above NTA.
4	**Nearmap**	Using proprietary technology, nearmap captures high resolution images of cities from light aircraft and renders them seamlessly on a subscription based website within 2 days of capture (a more current and clear version of Google Earth). Australian revenues are growing off a relatively fixed cost base with first sales recently secured in the much larger US market. Nearmap's growth and investment is being funded internally by their strong free cash flows.
4	**Netcomm Wireless**	Global leader in wireless communication devices with a focus on the burgeoning Machine to Machine (M2M) wireless Internet of Things. Netcomm has partnered with some of the world's leading Telco carriers such as Vodafone, Singtel and Verizon and has secured the contract for supply of the Fixed Wireless device component of Australia's National Broadband Network (NBN). We believe their traditional business plus the NBN contract underpin the share price with any growth, which could be substantial, coming free.

One bubble deflates …….. while another inflates even further



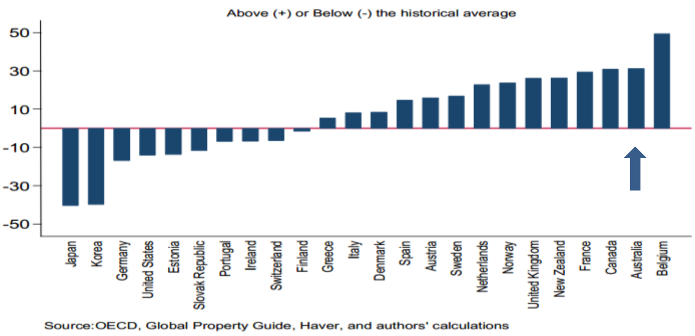
Source: Minack advisors (original source ABS, Butlin, RBA, Melbourne Institute)

Australia's mining capex peaked in 2013 at 8% of GDP as illustrated above. The declines since 2013 have been offset by a jump in the volume of commodity exports (due to new mines and expansions) and modest growth in consumption, to produce overall positive GDP growth thus far.

The most recent Australian Bureau of Statistics (ABS) quarterly Capex survey anticipates a 35% drop in Mining capex to around 3.25% of GDP next financial year with overall business capex forecast to drop by roughly $40b, a significantly bigger hole than the $13b drop in the current year.

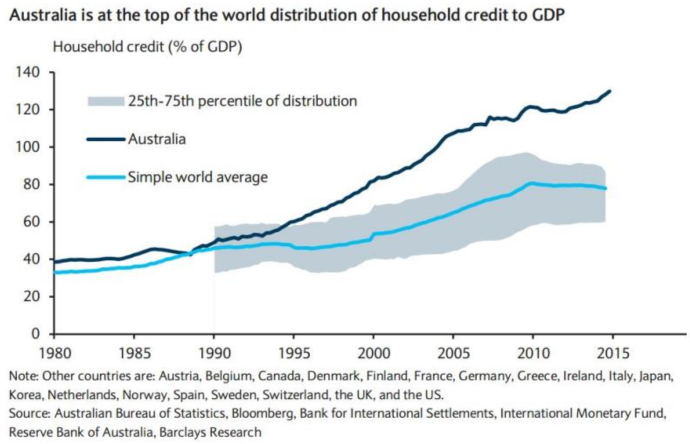
Greater reliance is being placed on the booming residential construction sector to fill the hole from the capex downturn. Unfortunately housing construction booms are relatively short lived affairs and rely on increasing house prices to sustain the boom. With **Australia's house prices, household debt levels and proportion of wealth concentrated in housing already amongst the world's highest** this seems like a tall order.

House price to Median Income relative to historical averages:



Source: businessinsider.com.au 12-6-2015 article

Australia has the most indebted households in the world with Household debt to GDP at 130%. The following chart illustrates Australia's extreme (and accelerating) household leverage in a global context:



Source: Sydney Morning Herald 16-3-2015 article

The strong growth in mortgage debt has been a boost to Australian bank balance sheets and profitability, which is now a record share of the Australian economy. Banks now represent 30% of our total stock market capitalization relative to a 15% global average. Mortgages now represent about 60% of total banking assets, another world record. Australian banks are effectively highly leveraged mortgage hedge funds.

Recent strong price growth, particularly in Sydney, has prompted regulators (Reserve Bank, APRA and ASIC) to publicly highlight the growing risks and in some cases tighten rules and increase bank scrutiny.

In a nutshell:

As Australia's mining boom fades, our economy, stock market and household wealth have become more and more dependent on and concentrated in (dare I say it) the bubble that is Australian Housing. I confess to now being a very conflict riddled home owner!

Although we are not able to predict the short term path for house prices, given the unhealthy conditions described above, we are very concerned about the Australian housing market and by extension Australian banks, consumer related stocks and the economy in general. Jencay continues to avoid those sectors.

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
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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