

# Jencay Australia Investment Fund

## Quarterly report – 31 December 2015

**JENCAY**  
capital

AFS Licence Number 402024  
ACN 148810413

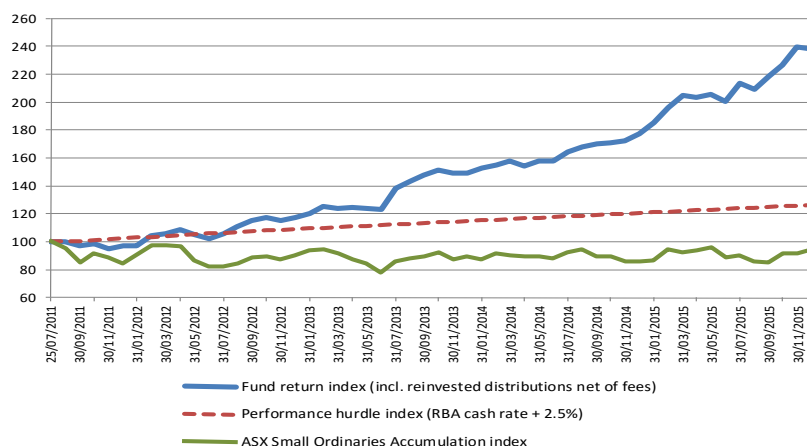
### Performance

|                                           | Since inception<br>(annualised) | Latest 12<br>months | Latest<br>Quarter |
|-------------------------------------------|---------------------------------|---------------------|-------------------|
| <b>Fund total return</b>                  | <b>21.6%</b>                    | <b>34.4%</b>        | <b>8.9%</b>       |
| Performance hurdle (RBA cash rate + 2.5%) | 5.4%                            | 4.7%                | 1.1%              |
| ASX Small Ordinaries Accumulation Index   | (1.2%)                          | 10.2%               | 11.3%             |

### Unit Price

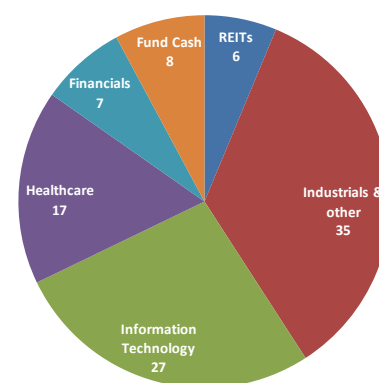
|                     |                        |                  |
|---------------------|------------------------|------------------|
| <b>NAV per unit</b> |                        | <b>AUD 2.044</b> |
| Application price   | (0.5% spread added)    | AUD 2.054        |
| Redemption price    | (0.5% spread deducted) | AUD 2.034        |

### 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 37.5m

A strong quarter for equities saw small caps significantly outperforming large caps with the ASX Small Ordinaries Index jumping 11% in comparison to a 7% gain for the ASX All Ordinaries Index. Our Fund was up 9% for the quarter. Nearmap reappears in the fund's top ten following additional purchases. Emerchants, which the fund has held for a couple of years, entered the top 10 for the first time following price gains. Longstanding positions, Servcorp and Integrated Research, slipped out of the top ten but are both still core holdings of the fund. Netcomm, Pro Medicus and Medical Developments performed very strongly in 2015 – we discuss why we have not sold them on page 2.

### Top 10 Positions

| Weight % | Name                              | Summary Investment Case                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|----------|-----------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10       | <b>Netcomm Wireless</b>           | 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 supply contract for the Fixed Wireless device component of Australia's National Broadband Network (NBN). Refer to page 2 for additional comments.                                                                                                                                                                                                                                              |
| 7        | <b>Pro Medicus</b>                | Radiology software for practice management and remote image viewing. The pipeline of opportunity for their world leading radiology image viewing platform continues to grow following 6 significant US client wins in the last two years as well as a recent win in Germany. Refer to page 2 for additional comments.                                                                                                                                                                                                                                                                                                                                               |
| 5        | <b>GBST</b>                       | 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 and Asia. The share price dropped back further this quarter following the resignation of its longstanding CEO and a profit downgrade. We took the opportunity to top up on the back of this weakness as we have confidence in GBST's long term prospects and its valuation is very reasonable now.                                                                                                                                                                                                 |
| 5        | <b>Medical Developments</b>       | A rare example of a biotech that has been profitable since IPO 11 years ago, and not raised any capital. It has been supplying Pentrox, 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. Refer to page 2 for additional comments.                                                                                                                                                                                                                                                        |
| 4        | <b>Galileo Japan Trust</b>        | 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 approaching 9%. Rentals and valuations are trending up in Japan. In contrast to GJT, Japanese domiciled REITs are currently trading significantly above NTA.                                                                                                                                                                                                                                                                                                            |
| 4        | <b>nearmap</b>                    | 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. The share price took a hit this quarter following a change in CEO. We believe the CEO change should not upset momentum and therefore bought additional shares at the cheaper entry price. |
| 4        | <b>emergants</b>                  | Emerchants is a leading provider of prepaid cards and related technology in Australia and the UK. Revenues are growing strongly due to its leadership in providing solutions for new and growing market niches including online gaming. The business is extremely scalable with additional revenues largely falling to the bottom line. We believe the current share price reflects the benefit of secured contracts only, with any additional business wins effectively free.                                                                                                                                                                                      |
| 4        | <b>Austal</b>                     | The world's leading aluminium ship builder with significant, long term US Navy contracts in addition to its commercial and other military sales. The share price dropped 1/3 <sup>rd</sup> during the quarter following a profit downgrade due to contract slippage and speculation regarding the sustainability of one of their programmes beyond the contract period. We believe the price reaction was overdone and took the opportunity to top up our position.                                                                                                                                                                                                 |
| 4        | <b>Spicers (Ords and Hybrids)</b> | During the quarter, the company changed its name from Paperlinx to Spicers, its biggest trading business. After placing their European subsidiaries into Administration, the group is left with a solid paper wholesale business operating across Australia, New Zealand and parts of Asia. It has net cash equivalent to 4/5ths of the combined market cap of the Ordinary Shares and Hybrids and should generate healthy profits and cash flows moving forward. At the current market valuation, downside seems low but upside significant.                                                                                                                       |
| 4        | <b>Thinksmart</b>                 | Provider of consumer credit via leading UK electronics retailers. With about 40% of the company's market cap backed by cash, the business effectively trades on a P/E multiple of only 5 to 6 notwithstanding strong growth potential.                                                                                                                                                                                                                                                                                                                                                                                                                              |

## Why we have held onto our top performers

The strong recent gains of the fund have been driven primarily by three stocks, all of which have been held for about two years, as tabulated below:

|                   | Netcomm Wireless | Pro Medicus | Medical Developments |
|-------------------|------------------|-------------|----------------------|
| Average Buy price | 40c              | 83c         | \$1.16               |
| Current Price     | \$2.93           | \$3.35      | \$3.67               |
| % gain            | 630%             | 300%        | 215%                 |

Despite the strong gains shown above we have sold very little of these shares even though they are now the biggest positions in the portfolio. We admit it has been hard fighting the instinct to realise profits and take money off the table but we believe this is the appropriate course given our view that upside still exceeds downside in all three cases for the reasons explained below.

### Netcomm Wireless

Netcomm's traditional \$40m broadband business together with their non-NBN M2M business covers the majority of their overheads. Their exclusive NBN contract is expected to generate peak (and potentially recurring) revenues exceeding \$100m p.a. which should contribute roughly \$25m p.a. to pre-tax profit. Those components alone justify the majority of the current \$400m market cap before taking into account the recently announced, company transforming, fixed wireless rural broadband contract with AT&T that has the potential to generate peak revenues of \$300m p.a. and a marginal contribution of circa. \$50m p.a. The contract reinforces Netcomm's position as the global leader in rural broadband which should lead to more business. At the current share price, it seems that only a modest amount is being paid for the AT&T contract and any additional new business wins are free. Netcomm is trading at only 8x the average broker EBIT forecast for 2018.

### Pro Medicus

At face value the current Enterprise value, now exceeding \$300m, looks excessive relative to the \$5m pre-tax profit generated in the 2015 year, however the following factors need to be considered:

- \$5m to \$10m of annual revenues will be added over the next two years based on contracts already secured. Importantly the business has very strong fixed cost leverage and cost discipline which means that the majority of incremental revenue will fall to the pre-tax profit line. Secured contracts should therefore boost pre-tax profits to \$10m/\$15m.
- The majority of the contract wins add transaction based annuity revenues that should grow with the growth in study volumes.
- In 2015 Pro Medicus added \$30m in contract value, which equates to annual annuity revenues of roughly \$6m. If it continues to win new business at that rate, it only needs about 2 to 3 years of additional wins to justify the current share price.

Downside for the company does seem limited based on the above facts. Upside could still be substantial if they continue to win work beyond the 2/3 year horizon or if their win rate accelerates. Both of these scenarios seem likely in view of the following:

- As they win more contracts with reputable clients and implement successfully, their credibility grows, enhancing their ability to win more deals - the pipeline is about 1.5 to 2 times as large as it was 12 months ago.
- Their win rate in tenders has been above 80% over the last two years.
- Industry dynamics are helping – incumbent legacy technology, primarily provided by the large imaging hardware providers, has become slow and cumbersome and momentum is building for their replacement with best of breed technology components i.e. unbundling the software from the hardware. Pro Medicus' Visage is considered best-in-class in radiology imaging software with a small footprint and exceptional speed. They continue to innovate to keep their technology at the forefront.

Based on our numbers the shares are trading on less than 10x our 2019 forecast EBIT. Admittedly a long term view is needed but upside seems to outweigh the downside.

### Medical Developments (MVP)

Although MVP's \$220m market cap looks stretched relative to its latest \$2.2m pre-tax profit (100x), revenues and profits should grow dramatically off the back of recently concluded European distribution contracts for Pentrox. European sales of Pentrox alone could realistically reach \$100m in 3 to 5 years' time, which would add circa. \$50m to pre-tax profit, more than justifying the current valuation. The following additional free growth options are available:

- US FDA approval for Pentrox will be applied for shortly. The US market could add a multiple of projected European revenues.
- Sales to a number of countries outside of Europe and the US are starting to ramp up and additional territories are being brought online rapidly, some with upfront milestone payments attached.
- The Space Chamber asthma spacer is starting to gain traction in international markets, with significant upside potential.

There is a risk that sales disappoint, however we believe MVP's upside potential significantly outweighs its downside.

**Buffett is of the view that if one finds a quality stock it should be held forever. Whilst we prefer not to make such absolute statements, particularly given the accelerating disruption being brought about by technology changes, we will try and keep holding our investments while our perception of upside continues to exceed downside and until we identify stocks with more attractive risk/return profiles.**

## Fund Key Features

Comprehensive Terms are contained in the Information Memorandum which can be downloaded from the website [www.jencay.com.au](http://www.jencay.com.au) or sent to you upon request

|                                      |                                                                                                                                                                                                                                                                                                                                                                                         |
|--------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Custodian</b>                     | JP Morgan Chase Bank N.A.                                                                                                                                                                                                                                                                                                                                                               |
| <b>Administrator</b>                 | White Outsourcing Pty Ltd                                                                                                                                                                                                                                                                                                                                                               |
| <b>Fund auditor</b>                  | PricewaterhouseCoopers                                                                                                                                                                                                                                                                                                                                                                  |
| <b>Inception</b>                     | 25 July 2011                                                                                                                                                                                                                                                                                                                                                                            |
| <b>Investment strategy</b>           | 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. |
| <b>Product type</b>                  | Wholesale managed investment scheme available to wholesale clients and sophisticated investors                                                                                                                                                                                                                                                                                          |
| <b>Investment universe</b>           | All securities listed on the Australian Securities Exchange (ASX) and cash to be held on deposit                                                                                                                                                                                                                                                                                        |
| <b>Fund size cap</b>                 | \$200 million in net subscriptions. To manage liquidity, the Trustee may limit the quantum of monthly inflows.                                                                                                                                                                                                                                                                          |
| <b>Investment restrictions</b>       | <ul style="list-style-type: none"> <li>Maximum of 40 individual securities</li> <li>Maximum exposure of 15% to a single security</li> <li>No short positions</li> <li>No leverage</li> </ul>                                                                                                                                                                                            |
| <b>Minimum initial investment</b>    | \$100,000                                                                                                                                                                                                                                                                                                                                                                               |
| <b>Minimum additional investment</b> | \$20,000                                                                                                                                                                                                                                                                                                                                                                                |
| <b>Minimum redemption amount</b>     | \$20,000                                                                                                                                                                                                                                                                                                                                                                                |
| <b>Base management fee</b>           | 1% p.a. excluding GST. Management Expense Ratio 1.025% p.a. inclusive of non-recoverable GST.                                                                                                                                                                                                                                                                                           |
| <b>Performance fee</b>               | 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%.                                                                                                                                                                                                                                         |
| <b>Entry fee</b>                     | None                                                                                                                                                                                                                                                                                                                                                                                    |
| <b>Buy spread</b>                    | 0.5%                                                                                                                                                                                                                                                                                                                                                                                    |
| <b>Sell spread</b>                   | (0.5%)                                                                                                                                                                                                                                                                                                                                                                                  |
| <b>Redemption notice</b>             | 6 months' redemption notice required otherwise 5% early exit penalty to be applied                                                                                                                                                                                                                                                                                                      |

## Contact Details

|                                       |       |                                                                                        |                             |                 |
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## Disclaimer

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