

# Jencay Australia Investment Fund

## Quarterly report – 30 June 2017

**JENCAY**  
capital

AFS Licence Number 402024  
ACN 148810413

### Performance

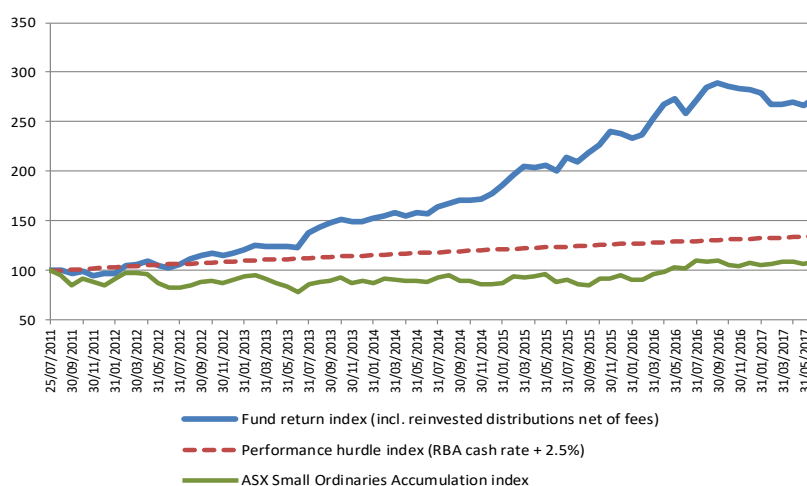
Returns are net of fees, exclude buy/sell spreads and assume reinvestment of distributions/income	Since inception (annualised)	Latest 12 months	Latest Quarter
<b>Fund total return</b>	<b>18.6%</b>	<b>6.2%</b>	<b>2.5%</b>
Performance hurdle (RBA cash rate + 2.5%)	5.1%	4.1%	1.0%
ASX Small Ordinaries Accumulation Index	1.4%	7.0%	(0.3%)

### Unit Price

	Cum*	Ex*
<b>NAV per unit</b>	<b>AUD 2.2604</b>	<b>AUD 2.1731</b>
Application price		AUD 2.1839
Redemption price		AUD 2.1622

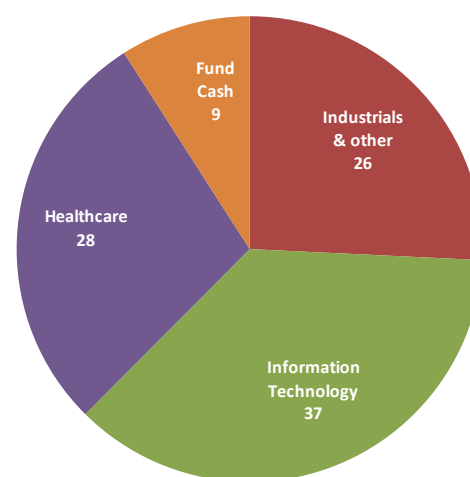
\* The Cum price is inclusive of the 8.74c June distribution. The Ex price is net of the distribution.

### 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 62m

The fund recouped some of its losses in the March quarter with a 2.5% gain in comparison to a flat ASX Small Ordinaries Index and (1.5%) decline for the broader ASX All Ordinaries Index. Many of the stocks that were weak in the March quarter have rebounded somewhat. Redbubble emerged in the Top 10 for the first time following strong price gains, replacing Adslot whose price decline has pushed it out of the Top 10. I provide feedback on a recent US trip on the next page.

### Top 10 Positions

Weight %	Name	Summary Investment Case
6	<b>GBST</b>	Leader in the provision of stockbroking and wealth management platform software in Australia, the UK and Asia. GBST had a quiet June quarter with no material news and a relatively stable share price.
6	<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 and US sales are building. Nearmap's share price strengthened following weakness in the March quarter.
6	<b>Medical Developments</b>	The company has been supplying Pentrox, an extremely effective inhaled analgesic (pain killer) in emergency medical settings in Australia for 30 years but only recently entered foreign markets. Additional distribution arrangements/approvals were secured for Pentrox and for their world class asthma spacer during the quarter.
5	<b>Pro Medicus</b>	Leading radiology image viewing platform with significant US client wins in the last two years including the prestigious Mayo Clinic and Mercy hospital group. The company had a quiet quarter with no major deal announcements.
5	<b>Redbubble</b>	<a href="http://www.redbubble.com">www.redbubble.com</a> is the world's leading global online platform connecting artists and fulfillers with customers. The platform houses an enormous library of unique graphic images that can be selected by customers and printed by 3 <sup>rd</sup> party fulfillers onto an extensive range of blank products including t-shirts, mugs, mobile phone cases etc. for shipment to the customer. Redbubble's growth is underpinned by an expanding range of images, products and new geographic markets. Revenues are a sizeable \$140m and profitability should be attained within the next 12 to 18 months. Redbubble missed its IPO growth projections which resulted in a very weak share price and an opportunity to buy into this quality marketplace at a modest valuation.
5	<b>Integrated Research</b>	Global leader in performance monitoring and diagnostics software for business-critical IT infrastructure in particular Unified Communications and Contact Centres. A quarter of Fortune 500 companies use their software. We anticipate strong future profit growth due to a shift from perpetual to term licenses and strong product traction. A new CEO was appointed during the quarter.
5	<b>3P Learning</b>	Online learning company, best known for its world leading online maths homework tool called Mathletics which has 4.6m users spread over 20,000 schools across the world. It also distributes Reading Eggs, a popular e-Literacy tool, and has a 40% stake in Learnosity, the global leader in generic online assessment APIs.
5	<b>Universal Biosensors</b>	Holds unique electrode IP that has proven extremely valuable in point-of-care blood diagnostics. Lifescan's market leading One-touch Verio blood glucose analyser utilises their technology for diabetes management. UBI is also the exclusive supplier of the disposable strips used by the UBI designed Siemens Xprecia Stride blood coagulation analyser which was launched recently and is making progress penetrating the market for Warfarin monitoring. UBI is profitable with significant downside protection and unlimited potential.
5	<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 significant contracts with Australia's National Broadband Network (NBN) and large foreign Telcos and a growing pipeline of opportunities. The share price recovered from its March quarter weakness despite no new announcements.
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. Additional US Navy orders were procured during the quarter and Austal entered into a teaming agreement with Australia's largest naval ship builder, ASC, to bid for the forthcoming Australian Navy Frigate programme which is very sizeable.

## Feedback from my recent trip to the US

I spent 10 days in the US in early May visiting the US operations of some of the companies in the portfolio and attending the Berkshire Hathaway AGM in Omaha Nebraska. I'll take the opportunity in this quarterly report to provide some feedback from the trip.

### Company visits

At least half of the companies in our portfolio have a significant presence in the US. I was able to visit six of our portfolio companies (some of which are not in the top 10) and summarise observations from those visits below:

<b>Redbubble</b> San Francisco	60% of their revenues are generated in the US and about 40% of staff are based there. Good energy and enthusiasm in the office. Multiple opportunities for growth/improvement with the company very selective in prioritising projects based on return on investment.
<b>Ellex Medical Lasers</b> San Francisco Bay area	40% of their revenues are generated in the US. I visited the facility that manufactures the Minimally Invasive Glaucoma Surgery device called the iTrack microcatheter. They are doubling their clean room capacity following deployment of the newly created dedicated sales force in the US and early signs of traction.
<b>EML Payments</b> Kansas City	Following the acquisition of Kansas City based Store Financial US about a year ago (subsequently renamed EML Payments US), the US business now generates about half of group profit and a bigger share of revenues. The US business has a staff complement of 100 and its own payment processing infrastructure. They are well placed to win the scraps that are too small and complex for the banks but substantial for EML.
<b>Admedus</b> Minneapolis	Although Admedus has not appeared in our top 10 list to date, it has a weight of 3% in the fund. Admedus has three parts to its business including a profitable Australian infusion product distribution business, a bovine cardiac tissue business which is in the commercialisation ramp-up phase but still burning cash and a clinical stage Immunotherapy platform (run by Prof. Ian Frazer, the developer of blockbuster Cervical cancer vaccine, Gardasil). The Group CEO, Chairman and US sales operation are all based in Minneapolis. The company's IP in the tissue space is world leading for cardiac repair with significant potential.
<b>Servcorp</b> New York	We visited Servcorp's floor on level 85 of 1 World Trade Centre. Despite the incredible views, the floor was very quiet. Servcorp's stubbornly high vacancy rate can be contrasted to the booming occupancies of "WeWork" and the plethora of new shared office space providers that are popping up. Although Servcorp is a well-managed business and has produced good returns for our Fund, our concern about the impact of the booming new supply on Servcorp led us to sell our holding subsequent to quarter-end.
<b>Austal</b> Mobile Alabama	Austal's Mobile facility employs 4200 people completing four US Navy ships per year under two programmes (The Littoral Combat Ship and the Expeditionary Fast Transport). The scale of the immense facility (circa 100,000 sqm under roof) is impressive. Although the future of the two key programmes is subject to constant military and political debate, it is hard to imagine the US Congress shutting the biggest employer in Mobile.

### Berkshire Hathaway AGM

I was very fortunate to attend the Berkshire Hathaway AGM in Omaha for the first time. It was an incredible privilege to see the wisdom of two of the world's best investment minds on display live. Sitting on the stage for six gruelling hours answering questions with exceptional clarity is an impressive feat for anyone - for an 86-year-old (Warren Buffett) and a 93-year-old (Charlie Munger) it is simply astonishing. Here are some observations that stood out for me:

- **ETFs** – Despite having made exceptional returns from active management, Buffett is a big supporter of Exchange Traded Funds (ETFs) which mimic market indices at a very low cost. Buffett's support for ETFs is due to the aggregate underperformance of active managers relative to the index, after their fees are deducted. Although I have tremendous sympathy for the argument, particularly in the more efficient large cap space, I do wonder whether the move to ETFs is now being taken too far given the enormous inflows that ETFs are attracting on the back of comments by the revered Buffett and others. The inflows into ETFs are starting to distort some market segments and consequences seem almost absurd - some ETFs now hold stakes of up to 20% in some companies - even illiquid small caps as exemplified by Van Eck's gold juniors index ([follow this link for an article discussing some of the issues](#)). Can it be a good thing when completely passive money with no interest in the value equation start to dominate share registers and trading activity? Is this the next market bubble?
- **EBITDA** – They were scathing about the use of EBITDA (Earnings before Interest, Tax, Depreciation and Amortisation) in assessing company valuations as EBITDA ignores any sustaining capital expenditure. Munger called the use of EBITDA "stupidity squared".
- **Driverless cars** could be a significant challenge to vehicle insurers - cars would be less likely to crash and hence premiums would be lower. Driverless trucks could result in truck transport becoming more competitive with rail and could impact their rail businesses. They were incredibly transparent in admitting these risks.

### Australians in the US

Australians had a notable presence both at the Berkshire AGM and in New York:

- My impression was that Australians asked the third highest number of questions at the Berkshire AGM with Americans first and Chinese second. Australian accents and faces were common in Omaha.
- While in New York my wife and I went to a comedy club in Greenwich Village and about 2/3rds of the audience were Australian with one of the comedians particularly surprised that a young Australian couple in the audience had chosen to get married in New York.

The above observations may merely be coincidental or reflect that Australians are big travellers or Buffett devotees. However, the cynic in me interprets it as more evidence of Australians living beyond our means on the back of our booming property values and world leading household debt.

## Fund Key Features

<b>Custodian</b>	JP Morgan Chase Bank N.A.
<b>Administrator</b>	Link Fund Solutions (renamed following Link Group's acquisition of White Outsourcing)
<b>Fund auditor</b>	PricewaterhouseCoopers
<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 most bargains are found amongst small caps.
<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>	The fund is now closed to new investors (subject to Trustee discretion) but will remain open for additional investment by existing unitholders
<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>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

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