

Jencay Australia Investment Fund

Quarterly report – 30 September 2017

JENCAY
capital

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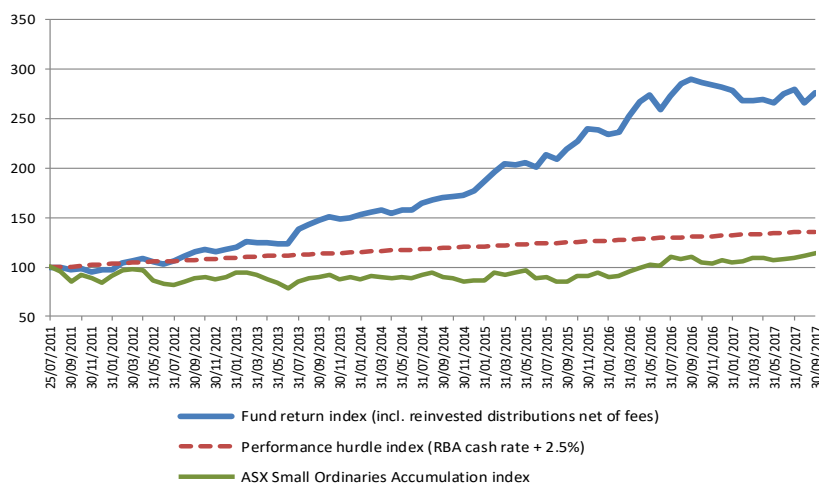
Performance

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	17.9%	(4.3%)	0.7%
Performance hurdle (RBA cash rate + 2.5%)	5.1%	4.1%	1.0%
ASX Small Ordinaries Accumulation Index	2.0%	3.0%	4.4%

Unit Price

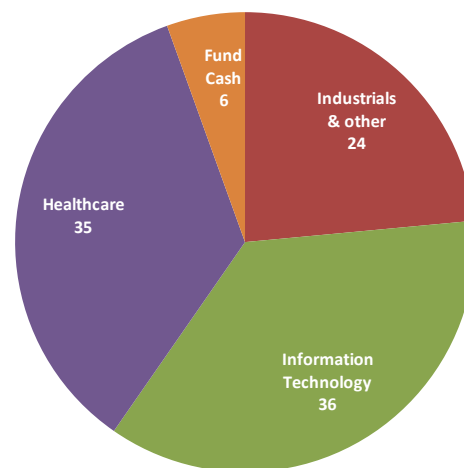
NAV per unit		AUD 2.1882
Application price (0.5% spread added)		AUD 2.1992
Redemption price (0.5% spread deducted)		AUD 2.1773

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 60m**

The fund was relatively flat for the September quarter in comparison to a strong 4.4% increase for the ASX Small Ordinaries Index and 1% gain for the broader ASX All Ordinaries Index. Ellex Medical Lasers returned to the top 10 list, replacing Netcomm Wireless, whose share price was very weak in the quarter. Netcomm Wireless did not conclude two contracts they previously flagged for closing and their cash position is looking a bit tight however 2018 should see a strong improvement due to locked in contracts with the NBN and AT&T and we remain positive on the company. GBST was the other big disappointment in the quarter – we provide more commentary in the section below. We believe the strength of the AUD relative to the USD and GBP during the quarter held back many of the stocks in the portfolio due to their large exposure to foreign revenues, despite good full year results to June. When the AUD started to decline toward the end of the quarter, many of those foreign earners rebounded strongly.

Top 10 Positions

Weight %	Name	Summary Investment Case
7	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. Their Australian business is profitable, very cash generative and still growing while the less mature US business is gaining momentum which will be assisted by their impressive recent 3D and oblique product additions.
6	Medical Developments	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 where sales are starting to grow strongly off a small base. Sales of their world class asthma spacer are also starting to get traction in foreign markets.
5	3P Learning	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 online e-Literacy tool, and has a 40% stake in Learnosity, the global leader in generic online assessment APIs. Signs of growth in the US are encouraging.
5	Pro Medicus	Leading radiology image viewing platform with a number of US client wins in the last few years including the prestigious Mayo Clinic and Mercy hospital group. The company had another quiet quarter with no major deal announcements but reported a strong and growing pipeline of tendering activity.
5	Integrated Research	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. Their software continues to win accolades and was recently added to Cisco's price list which will help streamline sales in that channel.
5	Ellex Medical Lasers	A global leader in lasers and ultrasound used by ophthalmologists in identifying and treating a plethora of eye diseases. The company's innovative, FDA approved disposable canaloplasty microcatheter for treating Glaucoma (iTrack) is enjoying strong sales growth following a significant investment in their US sales and marketing team. At the current price, little is being paid for the substantial potential.
4	Redbubble	www.redbubble.com houses an enormous library of unique graphic images that can be selected by customers and printed by 3 rd party fulfillers onto an extensive range of blank products including t-shirts, mugs, mobile phone cases etc. for shipment to the customer. Its enterprise value is roughly 1x sales, which is a remarkably low ratio for a world leading marketplace with robust growth (30% in 2017) and imminent profitability.
4	GBST	GBST suffered a large share price drop this quarter after an automated process by a 3 rd party to convert their legacy Wealth software code to Java did not work as planned. The code rewrite will now be taken in-house and as a result will take longer and cost significantly more than budgeted. We were very disappointed with this set-back but believe the share price reaction was overdone - the Wealth segment, GBST's largest, is now effectively free at the current market valuation. GBST has an impressive reputation in the industry, reinforced by their key clients expressing strong public support following their announcement.
4	Universal Biosensors	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 Xpreca Stride blood coagulation analyser which was launched recently and is making progress penetrating the market for Warfarin monitoring. UBI is profitable with downside protection and significant potential.
4	Austal	The world's leading aluminium ship builder with large, long term US Navy contracts in addition to its commercial and other military sales. Despite a busy period of orders, a solid 2017 result and strong 2018/2019 outlook, the share price has been relatively weak.

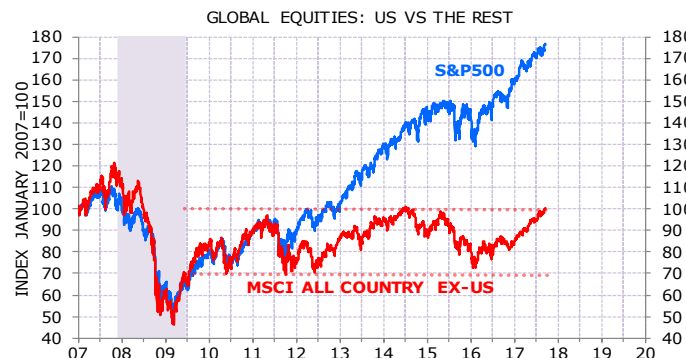
Fear of missing out

Equity, debt and property markets have been very strong over the last year with progressive new highs being reached in many markets. Easy gains breed complacency and fear of missing out (FOMO) and we believe both are in abundance at present.

Four areas of complacency include equity markets, debt markets, Australian housing and Chinese property as illustrated below, with the assistance of charts from Minack Advisors:

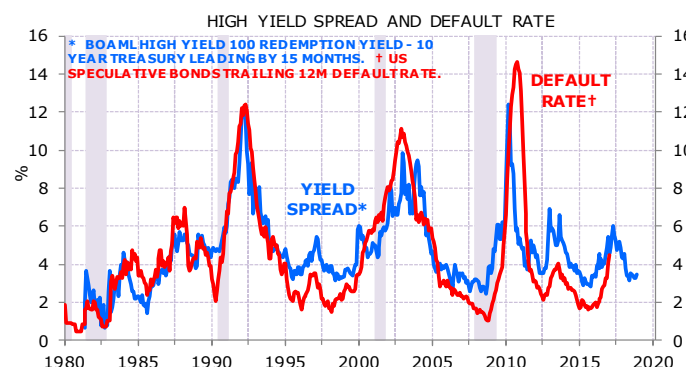
Global equity markets

US equity markets are at record highs and looking very stretched following strong gains. The value of private equity deals is at the highest level in ten years and the S&P 500 has not had a negative month this year. Equity markets outside the US have not risen quite as strongly but are near nine-year highs:



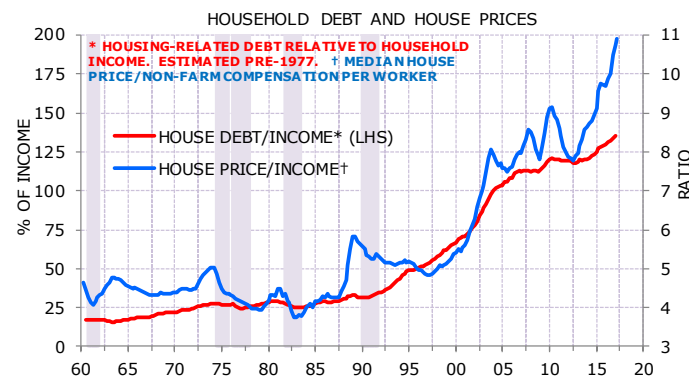
Debt markets

Although not at record lows, high yield spreads are tight relative to their historical range indicating more comfort than caution in the high-risk part of debt markets:



Australian residential property and household debt

This one needs no further explanation except to point out that average global house prices have declined relative to per capita income over the period below in contrast to Australia where house prices to income have more than doubled:



Chinese property, debt and capital exports

Chinese Debt to GDP continues to balloon. Authorities appear to be getting nervous and have begun reintroducing limits and rules on property investment. Of particular relevance to Australians and indeed to other countries that have been recipients of Chinese inbound investment, curbs on capital exports are being enforced by China as demonstrated by the acquisitive Chinese companies (inter alia Fosun, Wanda, Anbang) now being forced to sell their recent foreign acquisitions. Capital export restrictions on individuals are now being more actively policed too.

In conclusion

Over the last year the Fund has underperformed the market during a time when many market segments have performed strongly. This is frustrating as the majority of companies in the portfolio are making good progress at an operational level and increasing their intrinsic value.

Benjamin Graham, the father of value investing coined the phrase "In the short run, the market is a voting machine but in the long run, it is a weighing machine." In the short term, popular stocks or trends are rewarded due to FOMO but in the long term it is the stocks that continue to increase their intrinsic value that will prevail. The market is very fickle - today's hero may well be the villain of tomorrow and vice versa. Although the types of stocks in our portfolio have not been market favourites recently (mainly due to the strong AUD) despite their improving fundamentals, in the longer term the share prices should catch up to reflect those fundamentals.

The fund has been invested in parts of the market that have been overlooked during a time when risk taking has been rewarded. We would hope that the fund outperforms when the market inevitably returns to more risk consciousness and fear of missing out reverts to fear of ACTUAL LOSS.

Fund Key Features

Custodian	JP Morgan Chase Bank N.A.
Administrator	Link Fund Solutions (formerly White Outsourcing)
Fund auditor	PricewaterhouseCoopers
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 most bargains are found amongst small caps.
Investment universe	All securities listed on the Australian Securities Exchange (ASX) and cash to be held on deposit
Fund size cap	The fund is now closed to new investors (subject to Trustee discretion) but will remain open for additional investment by existing unitholders
Investment restrictions	<ul style="list-style-type: none"> ▪ Maximum of 40 individual securities ▪ Maximum exposure of 15% to a single security ▪ No short positions ▪ No leverage
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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