

# Jencay Australia Investment Fund

## Quarterly report – 30 June 2018

### Performance

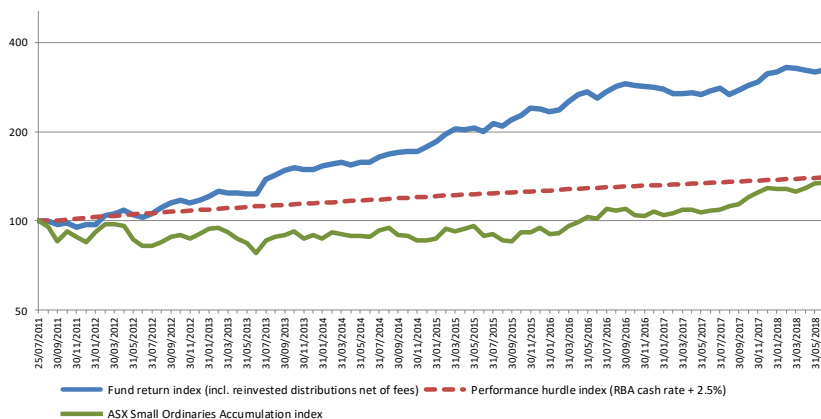
	Since inception (annualised)	Latest 5 years	Latest 12 months	Latest Quarter
Returns are net of fees, exclude buy/sell spreads and assume reinvestment of distributions/income				
<b>Fund total return</b>	<b>18.3%</b>	<b>21.1%</b>	<b>17.1%</b>	<b>(1.8%)</b>
Performance hurdle (RBA cash rate + 2.5%)	5.0%	4.6%	4.1%	1.0%
ASX Small Ordinaries Accumulation Index	4.4%	11.6%	24.2%	7.7%

### Unit Price

NAV per unit **AUD 2.5438\***

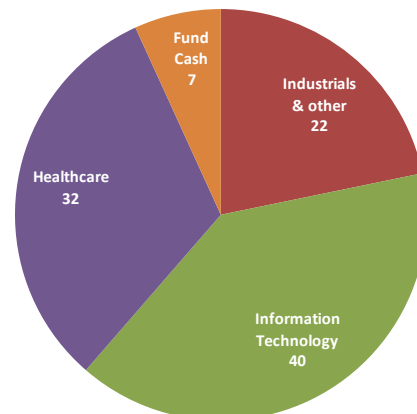
\* The NAV per unit is a cum-distribution NAV (i.e. inclusive of the June distribution yet to be finalised). Once the distribution has been calculated, ex-distribution redemption and application prices for 1 July will be produced and reflected on the website.

### 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. The chart now utilises a log scale on the vertical axis to reflect relative returns more clearly.

### Fund Composition



The market was very strong over the quarter with both the ASX Small Ordinaries Index and broader ASX All Ordinaries Index up 8%. In contrast, the Fund was down 2% for the quarter. We are nevertheless satisfied with the Fund's performance over the year to June 2018. A comparison of the Fund and the Index is set out on the next page.

Longstanding portfolio positions, Mineral Deposits and Jumbo Interactive, appeared in the top 10 list for the first time, with Ellex Medical Lasers and Clinuvel slipping below the top 10 due to share price weakness.

### Top 10 Stock Positions

Weight %	Name	Summary Investment Case
9	<b>nearmap</b>	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, assisted by their impressive recent 3D and oblique product additions. The valuation is still compelling despite a recent spike in its share price on the back of continued subscription growth and a commitment to temper cost growth.
7	<b>Redbubble</b>	<a href="http://www.redbubble.com">www.redbubble.com</a> is a world leading global marketplace connecting independent artists with 3 <sup>rd</sup> party fulfillers for on-demand production and distribution of unique products to end customers. Redbubble enjoys strong revenue growth (30% in 2017 and 2018) and will be profitable shortly but still trades at a modest valuation. The founder and CEO announced his retirement recently with the current highly regarded chief operating officer assuming the CEO position and the founder moving to a non-executive director role.
6	<b>Nanosonics</b>	Manufactures and distributes a unique device (the Trophon) that disinfects ultrasound probes using a proprietary Hydrogen Peroxide nano-mist process. Trophon is gaining rapid acceptance as standard practice in the industry with dependable, high margin consumable sales growing. A new generation Trophon will launch shortly. We topped up at a depressed share price early in the quarter due to heavy shorting activity which we found surprising given the company's strong long-term prospects. The share price bounced subsequently.
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 where sales are starting to grow strongly off a small base. Their asthma spacer has been core ranged in leading US pharmacy chains including Walgreens. The share price slumped in the quarter after downgrading their 2018 numbers due to some distribution delays. This seems to be a timing issue and we maintain our belief in the company's long-term prospects.
6	<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 online e-Literacy tool. Their 40% stake in Learnosity, was sold during the quarter for a big discount to book value and the share price dropped in response. Despite this disappointment we still believe upside exceeds downside for the remaining core business.
4	<b>Integrated Research</b>	Global leader in performance monitoring and diagnostics software for business-critical IT infrastructure, in particular Unified Communications. The share price dropped in the quarter following the release of a negative broker initiation report. We continue to believe in the long-term prospects of this quality business despite some short-term cashflow drag as the business transitions from upfront capital license sales to a SAAS (software as a service) model.
4	<b>Jumbo Interactive</b>	Leading online reseller of official Australian Lottery tickets via the <a href="http://www.ozlotteries.com">www.ozlotteries.com</a> website. Jumbo was one of the first online lottery resellers in Australia and has about a 1/3 <sup>rd</sup> share of online lottery sales. It has been in the Fund for almost 5 years but only entered the top 10 recently following strong price gains. It remains undervalued given its strong revenue growth of circa. 20% p.a. and fixed cost scale leverage now becoming evident.
4	<b>GBST</b>	Wealth platform and financial markets software. The transition of a massive number of Cofunds accounts to Aegon's GBST powered platform during the quarter went smoothly. The Vitality UK platform was also completed successfully, serving as a reference client for GBST's new digital front-end functionality.
4	<b>Austal</b>	The world's leading aluminium ship builder with large, long term US Navy contracts in addition to its commercial and other military sales. 2019 should see a jump in profit as utilisation in Australian and the Philippines ramp up with new orders.
4	<b>Mineral Deposits</b>	A heavy mineral sands miner with a large dredge mining operation in Senegal and smelter in Norway. During the quarter their joint venture partner, Eramet SA, launched a takeover offer at \$1.75 per share. Although this is below the fair and reasonable valuation in the target statement, it is almost 4x our average purchase price. This position will convert to cash shortly.

## Jencay vs. the market over the past year

Although the fund had a satisfactory year in absolute terms, with a gain of 17%, which exceeded overall market returns (14% for the All Ordinaries), it lagged the stellar performance of the ASX Small Ordinaries Index (XSO) which was up 24% for the year. We will investigate what drove the strength of the XSO over the past year and what this means going forward.

### Fund vs. index composition and performance

The composition of the Fund is significantly different to that of the XSO. The XSO comprises the 200 companies that sit below the ASX100 i.e. stock 101 down to 300, ranked by size. The Jencay Australia Fund is invested in 28 different companies but only 6 of those are included in the XSO with the remaining 22 sitting outside the XSO index and considered to be micro-caps. It is therefore to be expected that our Fund will perform very differently from the XSO.

The table below compares the sector weightings for the fund vs. XSO illustrating the fund's vastly different sector exposures to that of the Index:

	Jencay	ASX Small Ordinaries index		
	Weight %	Weight %	Total Return %	Contribution To Return %
Cash	6.9			
Consumer Discretionary	8.8	19.2	9.1	1.6
Consumer Staples		9.5	44.9	4.4
Energy		7.0	80.2	4.5
Financials	2.6	7.8	9.6	0.9
Health Care	30.3	6.6	8.6	0.5
Industrials	11.4	9.3	28.4	2.7
Information Technology	36.1	7.7	36.2	2.6
Materials	3.9	18.4	28.9	5.2
Real Estate		11.9	14.0	1.8
Telecommunication Services		2.1	7.5	0.2
Utilities		0.6	-0.3	0.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>24.3</b>	<b>24.3</b>

Source: Factset and Jencay

The following is clear from the above table:

- The majority of the XSO's performance came from three sectors: Consumer Staples, Energy and Materials. Those sectors are notably absent from our fund.
- Healthcare massively underperformed the overall index with a return of 8.6%. The fund's large weighting (30%) to Healthcare stocks including Nanosonics, Medical Developments, Clinuvel and Ellex was a headwind.
- The Fund holds 7% in low returning cash in comparison to the Index with a zero cash weighting.
- The Fund's large weighting to Information Technology, which had a strong year, assisted in mitigating the drag as described in the points above.

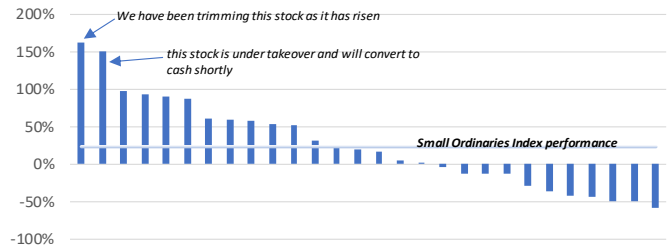
### Which stocks drove the Index?

A large portion of the XSO performance came from only a few stocks that jumped in price. The following 10 companies contributed almost half of the XSO's performance:

- a2 Milk Company
- Whitehaven Coal
- Beach Energy
- Altium
- Worleyparsons
- Mineral Resources
- Reliance Worldwide Corp.
- Costa Group Holdings
- Independence Group NL
- St. Barbara

Altium is the only stock out of the above ten that the Fund held during the year. Many of the above ten companies now have demanding valuations. It is also apparent that six out of those ten are Energy or Materials companies that benefited from strong commodity prices over the past year. Commodities are very cyclical and those stocks can fall as fast as they rose if prices return to previous levels. We generally shy away from large exposures to cyclical and speculative companies.

### Stocks remaining in Jencay Fund at 30 June – 12-month return



The chart above shows the 12 month returns for stocks in our portfolio at 30 June 2018. Many of the stocks in our portfolio underperformed the XSO over the last year and prices are therefore subdued. We have been buying many of the underperformers if considered appropriate. For those that outperformed, we are still comfortable with the valuation level, apart from those we have sold or that will exit the portfolio shortly, such as Mineral Deposits.

### Implications?

Trying to predict the stocks that will be next year's biggest winners is extremely difficult and a game we shy away from. We are in the business of finding quality stocks at attractive prices with sensible risk profiles that will provide solid returns over the long term while protecting investor capital. As a result, we will miss many of the rockets in our market but will also hopefully miss the inevitable return to earth for some of them.

We now sit with a portfolio that looks cheap relative to fair value and relative to the XSO in particular. Although this may mean nothing for performance in the forthcoming year, as short-term performance is impossible to predict, it should serve us well over the long-term.

As Warren Buffet says: **"Successful Investing takes time, discipline and patience. No matter how great the talent or effort, some things just take time: You can't produce a baby in one month by getting nine women pregnant."**

## 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"> <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>
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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