Abacus Hospitality Fund
Fund Update April 2013

Strategic Review
In June 2012 securityholders approved the implementation of a managed asset sale strategy where hotel assets in the portfolio will be considered for sale over the medium term (several years) as value and opportunities arise.

In line with this strategy the Diplomat Hotel located in Canberra, ACT was sold for $13.225m in October 2012 compared to its book value of $13.25m. From the sale proceeds $12.5m was used to repay bank debt. This has significantly reduced the bank loan to valuation ratio of the Fund to approximately 39%.

Insurance
Insurance cover was renewed in September and December 2012 for all of the assets in the portfolio. It is anticipated that insurance for the portfolio will continue to be available when the current cover expires in late 2013, absent any market changing catastrophe event.

Hotels owned by the Fund
The Fund now owns four hotels with 1,054 rooms:

- Rydges Tradewinds in Cairns, North Queensland with 246 rooms
- Rydges Esplanade in Cairns, North Queensland with 242 rooms
- Novotel Twin Waters Resort on the Sunshine Coast, Queensland with 374 rooms
- Chateau on the Park, Christchurch, New Zealand with 192 rooms.

The Queensland market remains difficult. Domestic and overseas visitor numbers are lower than in previous years because of the strong Australian dollar. There are however some signs of improvement in the Cairns market with revenue of the Funds' two Cairns hotels in the six months to 31 December 2012 approximately 5% ahead of the same period in the previous year. This improvement has been assisted by a pick-up in demand from Japanese tourists which declined in previous years after their tsunami natural disaster. More recently the Japanese Yen has depreciated against the Australian dollar. This may adversely impact on tourist numbers.

The Novotel Twin Waters Resort on the Sunshine Coast has experienced a reduction in revenue of approximately 9% compared with the prior corresponding period largely due to a weak corporate conference market.

The Chateau on the Park hotel in Christchurch is presently undergoing a major repair to fix the damage caused by the 2011 earthquake. Repair work has continued for almost a year and is expected to be completed in this calendar year. As a result a number of rooms have been unavailable resulting in lower hotel occupancy and room revenue compared with the prior year corresponding period. (The previous year benefited from high occupancy through demand from emergency and construction workers assessing the earthquake damage throughout the Christchurch CBD.) The total cost of the repair works currently identified is around NZ$7m. Most of the repair cost is expected to be covered by insurance, but there will be an assessment by the insurer to determine if any of the works are improvements rather than repairs to damage caused by the earthquake. The insurer also paid business interruption cover until the end of February 2013. In the six month period to 31 December 2012 the revenue of Chateau on the Park was approximately 16% less than the prior corresponding period.

Overall occupancy for the hotel properties was 74.5% for the period to 31 December 2012 compared to 70.8% for the period to 31 December 2011.

Asset Sale Strategy
A sale of the Chateau on the Park will be considered once the repair works are complete and trading levels have stabilised. The remaining hotels will need some time for trading to improve before a sale of any of these hotels will be considered.

Financial Statements

$m	Six months ended 31 Dec 2012	Six months ended 31 Dec 2011
Summary of Income Statement		
Total revenue	26.4	27.8
EBITDA	6.7	7.7
Profit/ (loss) after tax	(5.7)	(6.7)

$m	Balance sheet as at	
	31 Dec 2012	**30 Jun 2012**
Property assets	142.1	161.7
Gross assets	164.5	179.5
Net assets/ (liabilities)	(23.5)	(12.9)
Gearing (borrowings less cash over gross assets less cash)	35.3%	39.1%
Security value	$0.60	$0.69

The loss after tax of $5.7m for the period ended 31 December 2012 is after charging accounting depreciation of $2.0m, an adverse fair value movement of $1.3m in the interest rate swap book and an adverse fair value movement of $1.7m on the property, plant and equipment, all of which are non-cash expenses. Bank interest, interest on the Abacus loan and distributions to securityholders were substantially funded from cashflow from hotel operations.

The value of property assets decreased from $161.7m at 30 June 2012 to $142.1m at 31 December 2012, primarily due to the sale of the Diplomat hotel ($13.2m) and the devaluation of the Novotel Twin Waters hotel by $6m (from $66m to $60m). The weighted average capitalisation rate of the hotels was 9.48% as at 31 December 2012 which compares to 9.33% as at 30 June 2012.

Total liabilities decreased by approximately $4.4m due to bank debt reduction of $12.3m, an increase in the Abacus loan facilities of $6.5m and other movements in working capital of $1.4m.

The net asset deficiency of the Fund increased by $10.6m from $12.9m to $23.5m over the six month period due to the devaluation of Novotel Twin Waters Resort and the trading loss over the period.

The security value as at 31 December 2012 was $0.60 as calculated in the table below:

	Net assets/ (liabilities) ($000)	Securities on issue (000)	Security value
As at 31 December 2012 per financial report	**(23,509)**	**49,039**	
Abacus Working Capital Facility notionally converted to equity at $1.03 at Fund wind up	90,507	87,871	
Interest rate swap liability added back as this reverts to zero at the end of the swap term	15,548	-	
Adjusted net assets/ securities on issue	**82,546**	**136,910**	**$0.60**

Gearing

At 31 December 2012 the Fund had a drawn bank loan of $57.0m compared to $69.3m at 30 June 2012 with the reduction due to the Diplomat sale. This has led to a reduction in the bank loan to valuation ratio to c39% compared to the covenant maximum of 55%, and the strengthening of the interest cover ratio to 2.0 times compared to the bank minimum requirement of 1.5 times. In addition the gearing of the Fund at 31 December 2012 was 35.3% based on the net debt of the Fund (excluding the Abacus Working Capital Facility) as a percentage of gross assets less cash.

The Fund's bank borrowings are over-hedged as a result of repaying bank debt from hotel sales over recent years.[1] This has resulted in the Fund paying a higher interest rate compared with current interest rates. There is a potential liability of $15.5m as at 31 December 2012 which reflects the cost of the swap positions if these positions had to be paid out at balance sheet date. Interest rate swap positions were taken out by the Fund at the same time as bank debt was drawn down in order to fix the interest rate expense. Between July 2012 and March 2013

[1] Borrowings are over-hedged if the nominal value of the interest rate swap positions exceeds the aggregate drawn bank debt at a point in time. Interest rate hedging is commonly required by banks, and this was the case with the Fund's bank loans.

the Fund applied $5.45m of cash to reduce the over-hedging position and provide additional banking covenant headroom. At 31 March 2013 the Fund had an interest rate swap liability of $11.3m. This liability will reduce over time as the term of the interest rate swaps diminish. The Fund has engaged an independent treasury adviser to assist with strategies relating to the hedging profile. Strategies to reduce the over-hedging profile are constantly monitored and considered and will be implemented where appropriate.

The current bank facility expires in June 2014 and in the next financial year Abacus will work on extending or replacing this facility. That may require some restructuring of the hedge position.

Investor returns and liquidity for securityholders
The Fund is unlisted and has no available liquidity facility. Improved returns to investors will depend on asset value recovery.

The Fund has paid distributions equivalent to 4.5 cents per security per annum for the last two years, based on the operating cashflow of the Fund. Having regard to the under-performance of the hotels in the six month period to 31 December 2012 and current trading the distribution rate will be reduced to 0.5 cents per security for the quarter ending 31 March 2013 (paid in May 2013) and to 0.5 cents per security for the quarter ending 30 June 2013 (paid in August 2013). This will make the full year distribution rate 3.25 cents per security compared 4.5 cents paid in the previous year.

The Fund will continue to assess its distribution rate having regard to considerations including trading performance, insurance premium costs, swap restructuring costs and uninsured repair costs at the Chateau on the Park.

Outlook and Strategy
Hotel prospects in non-CBD locations in Australia remain challenging with a continuing strong Australian dollar adversely impacting Australian tourism. The Fund will continue with its managed sell down of assets over the medium term with the expectation that this may take some years.