**Abacus Hospitality Fund**
**Fund Update April 2014**

*Portfolio Update*
The Fund currently owns four hotel properties with a combined 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.

*Operations*
The table below shows the earnings before interest, tax, depreciation and amortisation (EBITDA) of the four hotels over the last three years (excluding management fees and the income from the Diplomat hotel which was sold in 2012):

| **A$000** | **Six months ending 31 December** | | |
|---|---|---|---|
| | **2013** | **2012** | **2011** |
| Tradewinds | 1,100 | 1,189 | 1,042 |
| Esplanade | 1,262 | 1,341 | 1,239 |
| Twin Waters | 3,887 | 2,768 | 3,058 |
| Chateau on the Park | 1,233 | 1,689 | 2,226 |
| Portfolio average occupancy | 76% | 75% | 75% |

The table demonstrates that the Cairns hotel market remains difficult with trading performance in 2013 still around the levels achieved in 2011. Domestic and overseas visitor numbers remain lower than in previous years because of the relatively strong Australian dollar and lower corporate and Government hotel expenditure.

The Novotel Twin Waters Resort experienced a reduction in revenue of approximately 9% in 2012 compared with the prior corresponding period largely due to a weak corporate conference market. In 2013 there was an improvement in conference activity, which contributed to a higher food and beverage income as well as room occupancy, and an increase in domestic leisure visitors.

The disruption during the repair works to the Chateau on the Park resulted in lower hotel occupancy and room revenue in 2013 compared with 2011 and 2012. 2011 benefited from high occupancy through demand from emergency and construction workers assessing the earthquake damage in the Christchurch CBD.

The repair work to the Chateau on the Park funded from insurance cover has been completed following the damage sustained in 2011 as a result of the Christchurch earthquake. The total cost of the repair work is around NZ$8m of which NZ$6.4m was paid by the insurer at 31 December 2013. The remainder is due to be paid by the insurer in the coming months. The insurer has also paid business interruption cover of NZ$2.5m and this income is reflected in the 2012 figures in the table above.

All hotels are insured following renewals in the second half of calendar 2013.

*Fund Financial Statements*

| **$m**<br>**Summary of Income Statement** | **Six months ended 31 Dec 2013** | **Six months ended 31 Dec 2012** |
|---|---|---|
| Total revenue | 30.0 | 26.4 |
| EBITDA | 6.8 | 6.6 |
| Profit / (loss) after tax | (1.0) | (5.7) |

| **$m** | **Balance sheet as at** | |
|---|---|---|
| | **31 Dec 2013** | **30 Jun 2013** |
| Property assets | 148.0 | 145.6 |
| Gross assets | 168.7 | 164.2 |
| Net assets / (liabilities) | (22.7) | (21.4) |
| Gearing (borrowings less cash over gross assets less cash) | 37% | 37% |
| Security value (see below) | $0.58 | $0.59 |

Total revenue in the period to 31 December 2013 includes $1.9m of receipts from the insurer to pay for material damage to the hotel (2012 – nil). The EBITDA for the period to 31 December 2012 includes $0.3m of rental income from the Diplomat hotel that was sold in October 2012. Bank interest, interest on the Abacus loan and distributions to securityholders were funded substantially out of the cashflow from hotel operations in both periods.

The Rydges Tradewinds hotel and Novotel Twin Waters Resort were both externally valued at 31 December 2013. The weighted average capitalisation rate of all four hotels was 9.4% as at 31 December 2013, unchanged from 30 June 2013. The Rydges Esplanade hotel and Chateau on the Park hotel will be externally valued shortly. The increase in the value of property assets in 2013 was principally attributable to the change in the exchange rate between Australian and New Zealand dollars. The depreciation of the Australian dollar increased the Australian equivalent value of the Chateau on the Park hotel at 31 December 2013. The New Zealand denominated bank debt liability similarly increased resulting in a limited change to net liabilities. Net liabilities increased from \$21.4m to \$22.7m as a result of the loss after tax and payment of distributions to securityholders.

The security value as at 31 December 2013 was \$0.58 as calculated in the table below:

| | Net assets/ (liabilities) (\$000) | Securities on issue (000) | Security value |
|---|---|---|---|
| **As at 31 December 2013 per financial report** | **(22,678)** | **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 | 11,190 | - | |
| **Adjusted net assets/ securities on issue** | **79,019** | **136,910** | **\$0.58** |

*Gearing*
At 31 December 2013 the Fund had a drawn bank loan of \$60.2m. Gearing was 37% compared to the covenant maximum of 55%. The interest cover ratio was 2.7 times compared to the bank minimum requirement of 1.5 times.

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 was a liability of \$11.2m as at 31 December 2013 (\$11.3m at 30 June 2013) which reflects the cost of the swap positions if these positions (which expire in July 2017) had to be paid out at 31 December 2013. 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. The swap liability will reduce over time as the term of the interest rate swaps diminish. We use an independent treasury adviser to assist with strategies relating to the hedging profile. Strategies to reduce the over-hedging profile are monitored and considered and will be implemented where appropriate.

The Fund has received a credit approved term sheet from a major Australian bank to refinance its bank funding for a three year term on substantially the same terms as the existing bank loan which expires in June 2014.

*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 paid distributions of 3.25 cents per security in the year ending 30 June 2013. Distributions are currently being paid at the rate of 0.5 cents per security per quarter. The Fund will continue to assess its distribution rate having regard to relevant considerations including trading performance, insurance premium costs and funding costs.

*Outlook and Strategy*
Hotel prospects in non-CBD locations in Australia remain challenging but there are signs of improvement as the Australian dollar depreciates in value relative to other currencies, the number of overseas visitors increases, including those from China, and Australian consumer and corporate confidence improves.

The Fund will continue with its managed sell down of assets over the medium term with the expectation that this may take some years. A sale of the Chateau on the Park will be considered when there is a reasonable track record of trading from the refurbished hotel. The remaining hotels will need some time for trading to improve before a sale of any of these hotels will be considered.

---

[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.