October 2018 – Datt Capital Absolute Return Fund

To our valued investors,

Thank you for entrusting your capital and co-investing with us.

For October the Fund provided a net return of -4.78% for the month. The majority of the return was driven by a fall in the share price of Afterpay which fell circa 28% in the month of October. We feel this is a minor blip in the short term, and feel the trajectory of the company's business growth is in line with our expectations.
We have now built a strong income generating base and feel we are well positioned to provide positive returns for our investors going forward.

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
FY19		2.6%	-1.2%	-4.8%									-3.49%

Approximate Asset Allocation for the Fund at October month end was:
CRE debt - 67.5% *includes deals committed but not yet settled
Equities - 17.5%
Cash - 15%

Investment review
Commercial real estate debt
This month we have evaluated four separate real estate debt opportunities, and selected two to invest in.
Regretfully, an opportunity mentioned in last month's newsletter fell through after the project sponsor opted not to proceed with the acquisition of the englobo land project located in Sydney's West. Accordingly, **this investment was not completed**.

We have made an investment in a 1st mortgage, syndicated land facility secured against an apartment development located in Melbourne CBD's southern fringe (Project C). The facility is for a 9 month duration with an optional attached 3 extension at the discretion of the lender, and will provide a return of 11% per annum with a minimum duration of 4 months payable. Maximum LVR allowable is 65%.

The project sponsors are an experienced offshore development group with significant local assets.The purpose of the facility is to assist with project development costs, which is already under construction and provide time for the sponsor to achieve sufficient pre-sales for a takeout project finance debt facility.

The project benefits from equity having been contributed by the sponsor over 2.1 times the land facility value; as well as having achieved pre-sales of 52% by value for stage 1 of the project. In addition, there is a clear exit as a term sheet has been issued for a construction debt facility once the project achieves the requisite level of pre-sales, which is expected by June 2019. We have examined and had discussions with a number of other industry participants in the immediate vicinity of the project; and we consider it the most attractive project in terms of price point, resident amenity and location relative to others in the area. Interest is paid monthly in arrears over the term of the loan.

We have committed to an investment in a 2nd mortgage, syndicated construction facility secured against an apartment development located in Sydney's inner east on the harbour side (Project D).
The facility has been in place since September 2016 and matures at the end of January 2019. The facility will provide a return of 14% per annum. We have been able to gain exposure to this strong opportunity due to the exit requirements of a member of this loan syndicate.
The project sponsors are an experienced offshore development group with significant local assets.The purpose of the facility is to assist with project construction costs, which were 96.5% complete by value with settlements due to begin in December 2018.
The project benefits from pre-sales amounting to 126% of debt coverage and a short maturity date providing a clear exit. In addition, there is little delivery risk remaining with the only real potential issue is settlement risk that is mitigated by the strong personal guarantees provided by the project sponsor.
Interest is capitalised monthly using a simple interest methodology. We expect this investment to settle in early November.

Our current real estate debt exposures are:

Name	Location	Type	Maturity	Max LVR/LSR	Expected Return per annum
Project A -Mixed use/Residential infill	Melbourne, Inner East	1st Mortgage Land Facility	August 2020	20%	11% with step up to 16% after 9 months
Project B - Industrial	Melbourne, Inner West	1st Mortgage Land Facility	June 2019	60%	11%
Project C - Residential infill	Melbourne, Inner South	1st Mortgage Land Facility	July 2019	65%	11%
Project D - Residential infill*	Sydney, Harbour side Inner East	2nd Mortgage Construction Facility	January 2019	70%	14%

* - Committed, not yet drawn down

From our research, there has been significant softening in the residential new build apartment market in Melbourne. Stock is still selling albeit at a much reduced quantum compared against the boom market of recent years. New supply for the upcoming years has been significantly reduced or reconfigured to alternative end uses; which bodes well for projects that are already under construction.

In contrast, the commercial office sector is booming with very low vacancy rates, low landlord incentives and rates per sqm increasing materially in city fringe locations. We have heard of a couple of transactions where companies have been prepared to pre-commit for entire office buildings with a delivery date of 2-3 years ahead in particular locations. The industrial sector is also becoming constrained in terms of capacity, and developments in key industrial locations are in high demand.

In spite of recent negative changes in legislation, Victoria is still enjoying a demographic tailwind in terms of population growth and we anticipate this will continue in the years ahead. From a risk perspective, our exposure in this space will generally be limited to Melbourne and Sydney; as they are the only areas within Australia to attract significant amounts of global capital. This provides a measure of insulation from being affected solely by local conditions.

Fixed interest
We continue to evaluate and watch a number of fixed income instruments in the distressed and special situation space with interest. While yields have softened somewhat, they are still not yet attractive enough to be investable from our perspective.

Derivatives
We have had some teething issues with our derivatives prime broker that we expect to resolve in November. As such we have had no exposure this month in this asset class.

Equities
We have made no equity transactions this month however, have been affected by the general market volatility experienced this month. Whilst we expect this volatility to continue over the coming months, we feel that we are well positioned with all our equity positions having clear and near term catalysts on the horizon.

The share price of Afterpay was hit very badly on a media article that unfairly characterised the company as a 'debt vulture'; a particularly noxious accusation considering the service is free for consumers and it’s structurally impossible to accumulate debt. Broadly, the perception was that a Senate enquiry into the 'Buy Now, Pay Later' sector would be detrimental to the company. We reached out to the 6 named Senators supporting the review, and consequently the Shadow Financial Services Minister has specifically supported Afterpay's regulatory model in parliament. Interestingly, the proposed government bill specifically excluded the 'Buy Now, Pay Later' sector; however, Afterpay have actually requested the bill to be extended to cover the sector as it does not compromise it's business model. Effectively, if Afterpay are successful in bringing the sector in under the bill; **it will enhance it's competitive position immensely as from our analysis competitors would no longer find it commercially viable to continue operating**. We feel this fact has not been understood by the broader market.
Afterpay have also released a positive business update demonstrating that their US expansion is proceeding well with a number of popular retailers joining the platform. We expect this holding to remain volatile but to provide high returns over time.

The broader equity markets have been relatively weak, and we are seeing good opportunities in some sectors beginning to arise. In particular, we have found a number of companies which hold strategic assets and that are trading materially under net tangible assets ('NTA'). This in itself is not necessarily an attraction for us, instead we like to focus on potential catalysts which could cause the firms' market value to converge with or increase over their respective NTAs.

Commentary
Going forward we will be changing the format of these newsletters. On a monthly basis we'll be providing our usual performance reporting but with no further commentary except around the investment review.
Our thoughts that we highlight in this section we will save for a longer format newsletter released quarterly.

We welcome feedback from our Investors with any questions, suggestions, comments or investment ideas.

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