September 2018 – Datt Capital Absolute Return Fund

To our valued investors,

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

For September the Fund provided a net return of -1.2% for the month. The majority of the return was driven by fluctuations in our equity investments. We expect future returns to be a little less volatile given a large portion of our portfolio is now deployed. We will not be making a distribution this quarter as we have not realised any gains, nor collected sufficient interest. We expect to start making regular distributions from this quarter.

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
FY19		2.6%	-1.2%										1.4%

Approximate Asset Allocation for the Fund at September month end was:
CRE debt - 54% *includes investments committed for but not yet settled
Equity - 22%
Cash - 24%

Investment review
Commercial real estate debt
This month we have evaluated four separate real estate debt opportunities, and selected two to invest in. Note that the investments described below have been committed to, but may not have settled by the close of September.

We have made an investment in a 1st mortgage facility secured against a medium scale industrial subdivision located in Melbourne's inner west. The facility is for a 9 month duration, and will provide a return of 11% per annum with a minimum duration of 4 months payable.
Maximum allowable LVR is 60%, with the initial LVR being circa 55%. The project sponsors are a consortium of well recognised real estate market participants.
The purpose of the facility is to provide funds to settle the purchase of the property, whilst providing time to work through any planning objections received, if any.
The project benefits from pre-sales amounting to over 90% of the stage 1 subdivision's end product and indicative credit approval on a takeout construction facility has been provided by one of the big 4 banks.
The facility is full recourse to the individual consortium members on a joint and individual guarantee basis, as well as corporate level guarantees. Interest is paid quarterly in arrears over the Loan term.

Another investment has been made in a 1st mortgage facility secured against a greenfield, englobo land project located in Sydney's outer western suburbs situated within a Priority Growth Area and will benefit from substantial, near-term infrastructure spend by the NSW government.
The facility has a 12 month duration, return of 10.5% per annum with minimum duration of 6 months. Maximum LVR is 65%, with the allowable LVR declining to 55% should development approval not be achieved after 9 months.
The project sponsors have successfully achieved development permits for a number of greenfield sites in the vicinity, over the past few years. Approval of the development application will significantly lift the value of the security property.
The facility is full recourse to the individual directors and the corporate entity. Interest is paid monthly in advance over the Loan term.

Fixed interest
We have analysed a number of fixed income instruments primarily in the distressed and special situation space. We have come across a few interesting situations which we are watching evolve with interest.
We have comprehensively completed our due diligence over the corporate entities and their respective industry structures, so we are well placed to take advantage of any potential mispricings in their fixed income instruments, as further news is released.

Derivatives
We expect to begin trading our derivative strategies in October. We expect this will be beneficial as we anticipate a rise in volatility in equity markets in the coming months, largely as a consequence of geopolitical events.

Equities
We took part in a placement in Aeris Resources which was issued at a discount of over 35% relative to it's market price.

Aeris operate a small copper mine, Tritton, and are the operator and 70% holder of the Torrens copper prospect that we had highlighted in last month's newsletter; and that we have current exposure to via our holding in Argonaut Resources.

Our thesis for this investment was manifold. In years past the company suffered from excessive and poorly structured debt obligations as well as poor operational performance. These issues have been now mitigated with the company's financier taking a haircut on the debt obligation, resulting in value accretion to the company of over $50 million. In addition, the new management team have turned the production assets around and are strongly aligned with shareholders via their incentive structure.

The company achieving strong operational cashflow in excess of $50 million for FY18; multiples of the company's capex and exploration requirements.

As such the opportunity to invest in the company at an approximate enterprise value of circa $104 million we deemed attractive, especially considering the near term catalyst in Torrens ahead; as well as the strong leverage to the copper price and any weakness in the Australian dollar.

We may make adjustments to our exposure to Torrens this quarter opportunistically as whilst we believe there is significant embedded value in our existing positions, we are cognizant of our controlling our exposure to a single project. At present, our collective equity exposure to the project is circa 6.5% by value; we expect to trim this down over time.

We continue to monitor a number of equities which we believe will provide strong returns in certain circumstances. In most cases, we are waiting for either a catalyst to evolve that may provide an acceptable time frame for our investment theses to play out; or, are waiting for the market value to diverge enough from our calculated fair value to provide an acceptable return for the risk undertaken.

Media this month

We were interviewed for a podcast by Rask Media this month, readers can listen to the interview by following this link: http://bit.ly/2Q7IhFn

We also wrote the following articles:
A study of scalability – http://bit.ly/2RhUOXZ
Afterpay: The journey ahead – http://bit.ly/2CYP4zF

Commentary

This month we've been asked what makes us different from other absolute return funds. We would unequivocally state that a large part of our difference stems from our investment philosophy and mentality.

We consider and treat the funds entrusted to us to be permanent and irreplaceable capital for our investors. We recognise and respect the opportunity cost of this capital and attempt to earn an acceptable return, whilst limiting downside and not neglecting longer term opportunities. We are not trying to achieve an acceptable return for our investors over 5 years as others, but strive to achieve an acceptable return year on year. We are passionate about finding exceptional investment opportunities, and as such work almost around the clock. For example, it is not unusual for the investment team to be sending each other thoughts, ideas and articles at 11pm on a Saturday night.

Our approach can be characterised by extreme intellectual flexibility and humility; we are not afraid of making mistakes and utilise methods to reduce the downside risk of our mistakes such as scaling into positions. In addition, we are not especially interested in advertising or marketing ourselves aggressively as we would like to attract the right kind of investor, with the right level of trust in our process and mentality.

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