

# Abacus Diversified Income Fund II



## Enhancement to Distribution Yield and Underwriting Commitment

November 2010

### 1. Introduction

This update contains additional information to be considered in conjunction with the PDS dated 24 December 2009 (PDS).

Abacus Funds Management Limited (AFML) as responsible entity of Abacus Diversified Income Fund II (ADIF II or Fund) is pleased to introduce the following product enhancements that benefit unitholders holding Class C and Class B units in the Fund.

- 1 Additional support provided by Abacus Property Group (Abacus) to the Fund, increasing the adjusted net asset value per unit from \$0.60 to \$0.84 based on the accounts at 30 June 2010, to satisfy its underwriting commitment in respect of the return of capital.
- 2 Distribution yield enhancement to 9% from 1 January 2011 with CPI indexation from 1 July 2011.

All other features of the Class C units described in the PDS are unchanged.

### 2. Additional Support for the Abacus Underwriting Commitment

Pursuant to an underwriting agreement, Abacus underwrites the return of capital and annual distributions to unitholders in the Fund<sup>1</sup>.

Abacus has agreed to increase the Abacus Loan Facility (Loan) to the Fund from approximately \$18m to \$48m. This Loan provides additional support to unitholders because the Loan cannot be repaid until after 30 June 2016 and at winding up of the Fund all or part of the Loan will be waived to the extent necessary to enable full repayment of unitholder equity. This subordination feature of the Loan provides support to unitholders in respect of Abacus' underwriting commitment to the Fund if at Fund termination the net assets of the Fund are insufficient to repay unitholder equity.

In summary Class B and Class C unitholders now have three levels of capital protection:

- net assets of the Fund backed by the real property assets;
- the \$48m subordinated Loan to the Fund; and
- the underwriting commitment from Abacus.

**Based on 30 June 2010 accounts and allowing for the \$30m increase to the Loan, the pro forma adjusted net asset value per unit increases from \$0.60 to \$0.84 after adjusting for the subordination benefit of the Loan.**

Please refer section 4 of this update for the pro forma balance sheet.

Note 1 - Investors should be aware that the purchasing power of a dollar invested today is worth more than the purchasing power of the same dollar in 2016 due to the effects of inflation. For example if the inflation rate was 3% per annum then \$100 in June 2010 would have the same purchasing power as \$84 in June 2010.

Note 2 - The \$0.84 weighted average cost of equity assumes all equity is raised in accordance with this updated offer. Even if all the equity is not subscribed and there remains a balance of the Abacus Working Capital Facility outstanding at Fund wind up unitholders will not be adversely affected because the Abacus Working Capital Facility ranks proportionately with equity upon Fund wind up (except that the Abacus Working Capital Facility does not participate in any upside).

For all unitholders to be repaid in full from the Fund (and therefore not rely on the Abacus underwriting) the adjusted net asset value on Fund termination date will need to be equal to or greater than the weighted average cost of equity.

The Fund capital structure has been enhanced so that the pro forma adjusted net asset value as at 30 June 2010 is equal to the estimated weighted average cost of equity per unit across all unit classes<sup>2</sup>.

We cannot project what the adjusted net asset value per unit will be at Fund termination but, if the adjusted net asset value today is equal to the estimated weighted average cost of equity, then the likelihood of there being an asset shortfall at Fund termination is significantly reduced.

The outstanding amount of the Abacus Working Capital Facility and therefore the amount of equity to be raised by the Fund will reduce by \$30m from approximately \$79m to \$49m to offset the increase in the Loan by \$30m. Accordingly ADIF II is now expected to issue approximately 65.3m Class C Units at 75 cents per unit to raise \$49m compared to the PDS which expected to raise \$73.5m through the issue of 98m Class C Units. Oversubscriptions may still be accepted.

In addition, effective 1 January 2011, the interest rate on the Loan will be reduced from 10% pa compounding to 9% non compounding in order to minimise any potential impact on capital growth prospects for unitholders. The Loan is repayable within 12 months if AFML is removed as the responsible entity of the Fund. The Loan is currently secured by second mortgages over certain real property assets and additional second mortgage security will be provided commensurate with the increase in the principal drawn balance. This security increase does not adversely impact the subordination features of the Loan.

### 3. Distribution Yield Enhancement

Due to the lower inflation outlook and the increases in interest rates over recent times, Abacus has agreed to underwrite a higher level of distributions from the Fund.

Class C Units	Current Yield Entitlement	Enhanced Yield Entitlement
Distributions paid quarterly	6.0 cents per unit or 8% per annum CPI indexed <sup>1</sup> from 1 July 2010 <sup>2</sup>	6.75 cents per unit or 9% per annum from 1 January 2011 with CPI indexation to apply from 1 July 2011 <sup>3</sup>
Underwritten	Yes – Abacus	Yes – Abacus

Note 1 - This is equal to 6.18 cents per annum for the period 1 July 2010 to 30 June 2011 or 8.24% per annum.

Note 2 - by reference to the CPI All Groups Australia Indexed from 30 June 2009

Note 3 - by reference to the CPI All Groups Australia Indexed from 30 June 2010.

This distribution yield enhancement to 9% per annum from 1 January 2011 will apply to all Class C units and Class B units.

Class C units will have an underwritten yield of 3.09 cents per unit for the six month period ended 31 December 2010 (equalling 8.24% on an annualised basis on the \$0.75 issue price). This will increase to 3.375 cents per unit for the next six month period ended 30 June 2011 (equalling 9.0% on an annualised basis on the \$0.75 issue price). From 1 July 2011, on an annual basis, the 9% yield will be indexed in line with CPI.

The increased cost to the Fund of the higher distributions is expected to be offset by the reduced and non-compounding interest rate of the Loan.

This yield enhancement is **not** available to the Class A Unitholders who do not convert to Class B units. Class A Unitholders will continue to receive a distribution of 8.5 cents per unit per annum (8.5% on the original issue price of \$1.00) until 30 June 2011. After that the distribution will reduce to the unsupported free cashflow of the Fund.

#### 4. Pro Forma Balance Sheet of the Fund as at 30 June 2010

The table below shows the actual balance sheet at 30 June 2010 and the pro forma balance sheet at 30 June 2010 on the basis of treating the Abacus Working Capital Facility as equity and after transferring \$30m from the Abacus Working Capital Facility to the Loan as described in this Fund update.

	As at 30 June 2010	
	Actual	Proforma
Gross asset value	194,708	194,708
Bank debt	(100,555)	(100,555)
Abacus Loan Facility	(18,007)	(48,007)
Mark to market liability of swaps	(5,903)	(5,903)
Other working capital	(8,564)	(8,564)
Net assets	61,679	31,679
Unitholder equity	(17,167)	(17,167)
Abacus Working Capital Facility	78,846	48,846
	61,679	31,679
Unadjusted net asset value per unit	0.43	0.31
Adjusted net asset value per unit	0.60	0.84
Units on issue <sup>3</sup>	141,843	101,843

Note 3 - Assumes the Fund is fully subscribed and the Abacus Working Capital Facility is converted to equity.

This update for Abacus Diversified Income Fund II (ARSN 116 429 844) is dated 17 November 2010 and issued by Abacus Funds Management Limited (ACN 007 415 590; AFSL 227 819) as responsible entity of the Fund. This information updates the product disclosure statement (PDS) dated 24 December 2009, a copy of which can be obtained from our website at [www.abacusproperty.com.au](http://www.abacusproperty.com.au). Applications for units in the Fund can only be accepted using the application form attached to the PDS.

The underwriting support enhancement provided by the Loan does reduce the unadjusted net asset value from \$0.43 to \$0.31 because the Loan is treated as a liability in the accounts and its subordination features are ignored. However, the more relevant measure for unitholders is the adjusted net asset value which adjusts for:

- The subordination benefit of the Loan because this Loan is not repayable until unitholder equity is repaid after 30 June 2016;
- The reversal of interest rate swaps (as these revert to a zero value at expiration of the swap term); and
- Assuming the conversion of the Abacus Working Capital Facility into equity.

The pro forma adjusted net asset value per unit as at 30 June 2010 is \$0.84 and comprises:

Net assets per unit as at 30 June 2010	\$0.31
Subordination benefit of the Abacus Loan Facility	\$0.47
Reversal of interest rate swaps	\$0.06

Bank debt gearing is unchanged. At 30 June 2010 the weighted average term to maturity of the bank debt was 1.4 years. The debt maturing in December 2010 is bank credit approved for an extension to September 2013 and once formalised this will increase the weighted average term to maturity of the bank debt to 2.2 years at the date of this update.

#### 5. Ranking of Class A, B and C Units in the Fund

All units in the Fund rank equally on a winding up of the Fund.

The underwriting commitment provided by Abacus means that any shortfall in the value of units in the Fund are unsecured debt obligations of Abacus which rank:

- behind any secured debt obligation of Abacus;
- ahead of ordinary equity of Abacus;
- equally with Abacus' other unsecured and unsubordinated obligations.

The underwriting commitment from Abacus will cease only if Unitholders vote to wind up the Fund prior to 30 June 2016.