

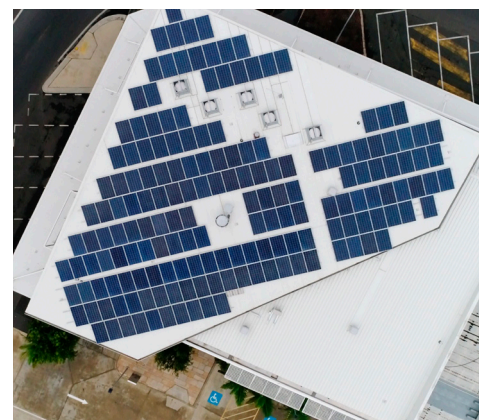
## Greetings

Welcome to Edition 10 of the Capricorn Diversified Investment Fund's (CDIF) newsletter – Fundamentally Speaking. The Fund has reopened to applications, some portfolio changes have been made and attractive new investment acquisitions are pending. We look forward to again delivering positive and stable returns after a challenging year. Please contact us if you have any comments or queries.

## The purpose of The Fund

The purpose of the Capricorn Diversified Investment Fund (CDIF) has not changed since its formation in January 2008. The Fund's key objectives are to generate regular income distributions similar to those of the broad Australian share market but with lower relative year-to-year volatility in asset value. The Fund's continuing tilt is toward recurring income rather than capital gains. A benefit to the investor is a more consistent performance compared with sometimes volatile market segments such as shares. These objectives were consistently achieved until the negative contribution from one asset last year.

CDIF provides indirect access to investments outside the reach of most individual investors, due to the minimum investment and wholesale investor designations required for participation in many deals. The benefit to the investor is a more diversified portfolio than they could otherwise hold themselves.



## Summary

The Fund's value (net of debt) as at the end of June 2020 was \$12,012,269 compared with \$12,437,499 the previous year. The difference is largely due to the payment of redemptions to investors who have left The Fund.

Material investment transactions in the last 12 months were the sale of the Embraer ERJ 135KL aircraft for US\$504,000, the sale of 5 percent of our holdings in the Eighth Gate Residences Fund No.6 for \$317,054 and a \$1.23 million capital return from Eighth Gate Residences Fund No. 6.

Debt secured by the Suncorp House asset reduced by \$157,500 during the year to the end of June 2020. Loan repayments are made monthly.

We established a \$1 million overdraft facility with the National Australia Bank for additional flexibility when investment opportunities arise.

All tenancies of Suncorp House are under lease agreements.

CDIF was holding \$573,618 in cash across its various entities as at the end of June 2020. Cash balances will increase to around \$1.6 million once we receive the capital return from Eighth Gate and fulfil outstanding redemption requests.

The Fund's unit price has changed little during the COVID-19 pandemic.

The Investment Committee and CIPL Board of Directors completed a strategic review of The Fund in late 2019. Please see the Strategic Review later in the newsletter for more information. We look forward to bringing you further updates on new initiatives later in the year.

## Suncorp House

Suncorp House in downtown Rockhampton is a significant asset of CDIF. The Suncorp Group, The Investment Collective and The Barbeque Box are the current tenants.

Suncorp vacated its branch office located on the ground floor in early October 2019. This lease agreement runs to December 2020 and Suncorp is obliged to continue paying rent until a new tenant is found or the agreement lapses. We are actively searching for an appropriate replacement. Suncorp will retain the corporate office on Level 1.

The ground floor, street-based space has been set up for use in the hospitality industry. In April 2019, a three-year lease agreement was signed to the operators of a Korean restaurant, The Barbeque Box.



### COVID-19

In April 2020, we granted The Barbeque Box a six-month rent-free period due to the COVID-19 pandemic. This arrangement will extend the lease period by six months. We have built a good relationship with the tenants and made this concession to secure our medium-term rental income.

## Eighth Gate Residences Fund No.6

We introduced Federation Villages (more formally known as Eighth Gate Residences Fund No.6) to the CDIF portfolio in 2015. Retirement villages in the portfolio include Federation Village Werribee, Federation Village Glenroy, Federation Village Sunshine and Federation Village Ballarat (under development). This investment historically paid quarterly distributions derived from site fee rent collected from residents and Deferred Management Fees (DMF) collected upon the sale of residences.

In August 2019, the security holders of the Eighth Gate Residences Fund No. 6 voted to approve the terms of Ingenia Communities' (ASX: INA) proposed acquisition of Eighth Gate's funds management business. As part of the proposal, INA offered to purchase up to 5 percent of existing unitholders' securities for \$1.10 per unit.

We allocated 5 percent of our holdings and received \$317,054 in cash, reducing our holding to \$6.02 million.

In December 2019, Ingenia reviewed the financial management and assets of the portfolio. The report concluded the portfolio was carrying excessive development risk from Federation Village Ballarat and recommended a meeting be held for unitholders to vote for one of the following options:

- Sale of Ballarat Development to Ingenia for \$7.0 million and return capital to unitholders.
- Retain Federation Village Ballarat, adjoining land acquired (with additional debt and capital funding being required).
- Retain Federation Village Ballarat, adjoining land not acquired (with additional debt being required).

Our preference was to remove any development risk and return to providing stable, consistent distributions. To that end, we voted in favour of Option 1, which was overwhelmingly supported by other cornerstone investors. We are excited to deploy the proceeds into opportunities that arise in the wake of the COVID-19 pandemic.

### COVID-19

Ingenia provided an update relating to COVID-19. At the time of writing, no residents had been infected and all communities were continuing to operate, although with significant protocols in place to restrict access to facilities. The majority of residents receive the Commonwealth Government pension and rent assistance payments so the Villages continue to receive stable rental revenues with no significant changes to returns. Although not mentioned in the update, it would be reasonable to expect a temporary reduction in sales volume of retirement units until residential property markets return to more normal conditions and a subsequent delay in the timing of DMF revenue.







## CDIF Solar

CDIF Solar holds a Retail 8 exemption from the Australian Energy Regulator. This exemption allows us to provide solar electricity systems to commercial customers under power purchase agreements (PPAs). Currently, there are systems servicing the tenants of Suncorp House in Rockhampton, another system servicing a fruit processing plant in Yeppoon and two new systems servicing a customer with a caravan park in Yeppoon and a commercial property in North Rockhampton.

The addition of the new systems brings our total portfolio to 164 Kw across four properties.

## Distributions

The Fund has paid \$2.7 million in distributions since 2012, at the rate of 1 cent per quarter. Management suspended distributions while the aircraft maintenance and sale project was underway. We look forward to recommencing distributions in the 2020/21 financial year.

## Redemptions

CDIF is an open-ended and unlisted managed fund that aims to provide investors with returns that are uncorrelated with equity markets. This mandate leads CDIF to invest in diversified assets that are often illiquid. As a result, redemption requests are met subject to availability of liquidity and quarterly redemption caps in order to ensure The Fund's unit price is maintained at a level that protects the remaining investors.

All redemptions are approved by the CIP Licensing Board of Directors. If approved, under an internal policy document, a maximum of 1.25 percent of The Fund's net assets can be redeemed by unitholders per quarter.

## Strategic Review

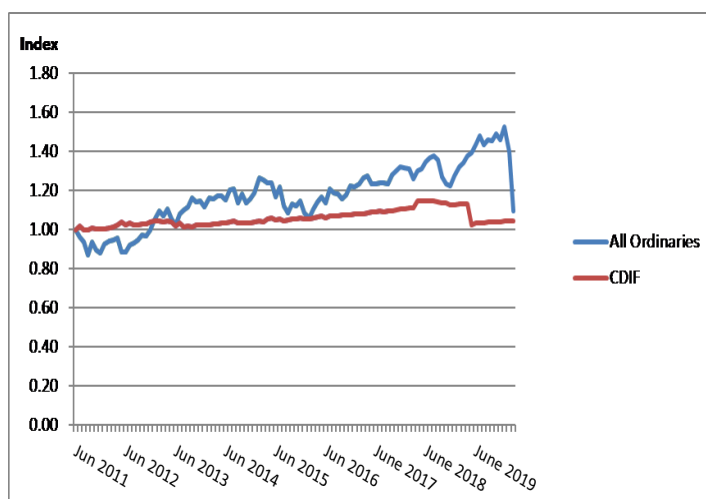
In November 2019, the Investment Committee held a strategy day to discuss The Fund's future. There is no doubt that the original objectives of The Fund are still valid:

- Low Volatility – over the last decade, availability of low volatility investments have been significantly diminished.
- Provide retail investors access to investments not generally available to retail investors. Increasingly, attractive investment opportunities are only available to wholesale investors, and this offering "space" is growing.

Despite the losses incurred on the aircraft lease, following COVID-19 driven correction, the returns from The Fund have been broadly similar to the Australian share market as a whole. Without the losses resulting from the aircraft lease, they would have been substantially superior (see chart below).

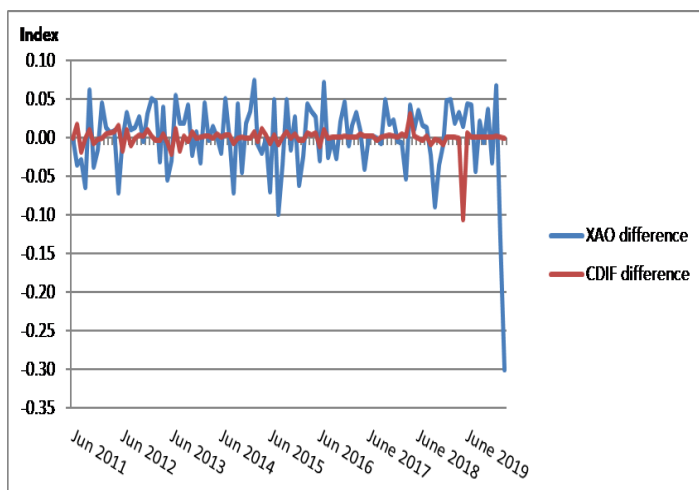
**Chart 1:** shows the relative stability of The Fund's NTA versus the All Ordinaries accumulation index since the start of the recent sell-off.

**Chart 1: CDIF NTA vs All Ordinaries accumulation index**



The All Ordinaries accumulation index experienced a 13 percent drop in February and 30 percent drop in March. Over the same period, The Fund recorded no material difference in NTA. Furthermore, Chart 2 illustrates the magnitude by which the market's 30 percent drop dwarfs The Fund's 11 percent drop recorded in 2019 after the write down of the aircraft.

**Chart 2: CDIF Volatility vs All Ordinaries Accumulation Index**



Although the All Ordinaries has recovered from its March lows, the large scale volatility of its returns in recent months highlights the need for investors to include diversifying, stable, real assets to portfolios.

## Conclusions

In summary, The Fund properly structured and positioned, is an ideal tool by which investors can access a growing range of attractive investment opportunities. Additionally, The Fund's cash balances and overdraft facility present an opportunity to take advantage of the recent COVID-19 driven sell-off. With this in mind, we determined the best way forward for The Fund is to:

- Collaborate with wholesale fund managers to access real assets.
- Introduce new expertise to the Investment Committee.
- Invest in new asset classes to take advantage of the COVID-19 sell down.

## Collaboration with Fund managers to access real assets

While it is important to have some level of liquidity to fulfil redemption requests and distributions, the focus of The Fund should be on maintaining exposure to real assets that are not susceptible to sell downs resulting from investors aggressively liquidating positions.

To date, the limitation in this approach has been the resources available to appraise and manage a large number of direct assets. The proposed solution is to collaborate with well-resourced fund managers that can make these investments on our behalf.

The themes of these investments should be similar to themes already explored/investments already made. The investment mix should reflect the requirements for acceptable returns, low volatility and sufficient liquidity.

## Additional Expertise

We were fortunate to have the opportunity to introduce Melissa Kingham to the Investment Committee at the start of 2020. Melissa has held executive positions with Woolworths Group Limited as Group Property Operations Manager and Group Manager Asset Services, she also worked with SCA Property Group as Fund Manager. Melissa has also held senior leadership positions within the public sector in both Commonwealth and State Government property departments.

Melissa's experience in property and fund management compliments the committee's existing expertise and she will bring valuable additional input on the strategy and direction of The Fund.







## Australian Small Cap Equities

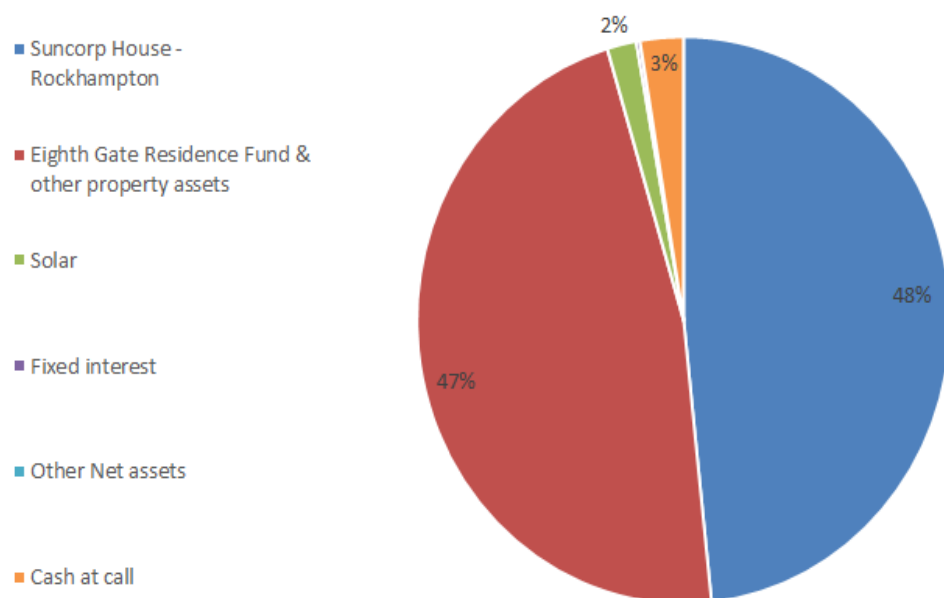
The Fund's current portfolio is heavily tilted towards property and renewable energy assets. We believe these asset classes provide acceptable returns, low volatility and generate income sufficient for liquidity. For those reasons, we are happy to continue sourcing wholesale fund opportunities in this space.

The Australian Small Companies Index (XSO) fell 40 percent during the COVID-19 sell off. The index has since rebounded in line with the broader recovery in risk assets. However, we believe attractively priced equities can be identified if the current levels of uncertainty persist.

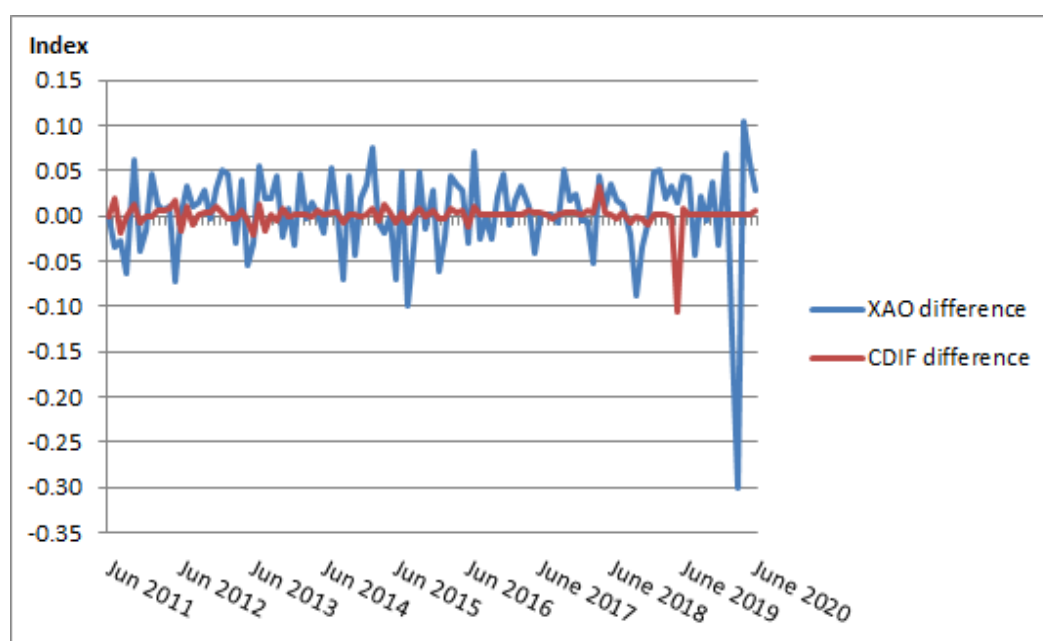
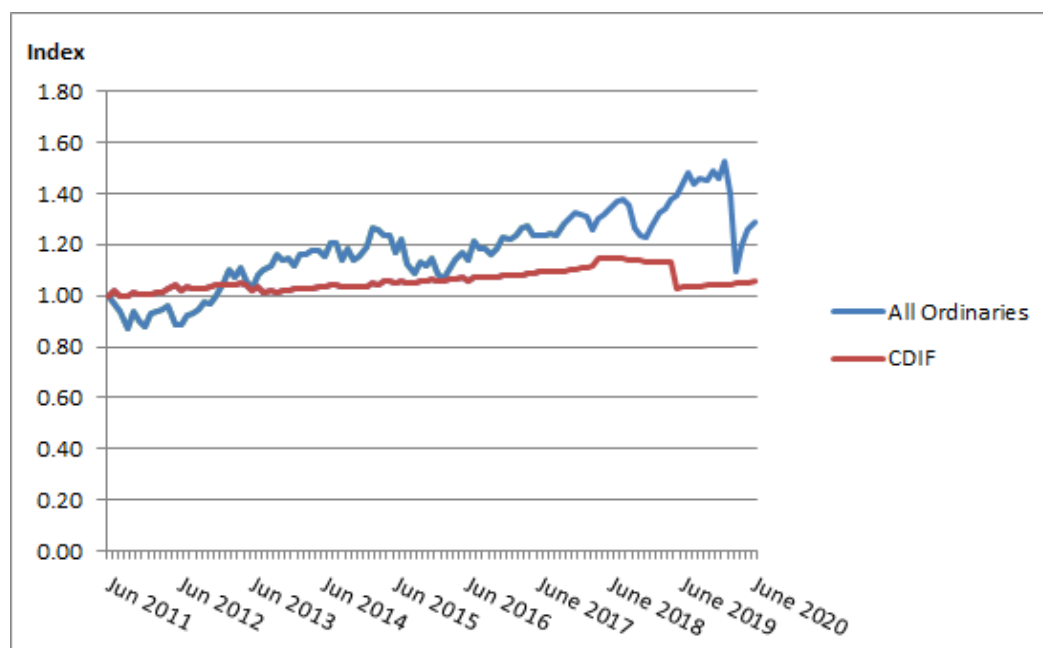
The Fund has previously invested in small cap equities and we are excited to deploy investors' capital in this asset class again. It is our intention to allocate a portion of the funds we expect to receive from the Eighth Gate Ballarat sale towards establishing the strategy. The initial size of this strategy will be capped to ensure the volatility of The Fund as a whole is not materially increased.

We look forward to updating you on the progress of this strategy.

## Asset Allocation & Property Lease Profile (June 2020)



The combination of capital value and distributions was showing an upward trend before the write down of the aircraft. We expect the trend to return to its previous trajectory with the potential to accelerate as The Fund increases in size:



Capricorn  
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Investment  
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