Redcape Hotel Group

Continuous Disclosure notice

Strategic review, Liquidity Facility and asset sales update

December 2023

Redcape Hotel Group Management Ltd, as the responsible entity (Responsible Entity or RE) of Redcape Hotel Group (Redcape or Fund), is writing to update investors about the status of the various initiatives being undertaken by MA Hotel Management (MAHM, the Manager) to deliver its key objectives for the Fund.

The Manager's initiatives are anticipated to deliver outcomes that enhance Fund performance in the near term and provide a sustainable framework for future growth. The Manager's immediate objectives are summarised as follows:

- Ensure the Fund has a strong balance sheet including an extended debt maturity profile
- Increase earnings through operational improvements, deployment of growth capital and recycling assets
- Sustainably reinstate the Fund's quarterly Liquidity Facility to facilitate an orderly withdrawal for unit holders wishing to redeem over time.

The Manager has made significant progress on the various workstreams that underpin these objectives and is pleased to provide updates below on key items.

Asset sales

Since June 2023, the Manager has successfully contracted to sell in excess of $175 million of assets to strengthen the Fund's balance sheet. Approximately $61 million has been settled to date, with the balance of the transactions to conclude by June 2024.

The speed at which these sales have been achieved in a difficult economic environment highlights the appeal of the hotel sector due to its unique investment fundamentals, and the continued demand for quality hotel assets.

A portion of the net proceeds from the asset sales will be applied to a permanent reduction of debt. The balance will be made available as working capital that can be applied to the Manager's growth capital strategies and facilitate the reinstatement of the Fund's Liquidity Facility so withdrawals may be met in an orderly manner.

Extension of Fund debt facility

The Manager is pleased to confirm that the Fund and its lenders have agreed to an extension of the tranche of debt maturing in September 2024. The Fund will apply $100 million from the proceeds of its asset sales to a permanent reduction of debt with a corresponding reduction in the Fund's finance costs.

As a result of this refinancing, the Fund's total committed debt will be reduced to $600 million and the weighted average term to expiry will be increased to 2.5 years. There are no further facility expiries until December 2025. Additionally, as part of the refinancing process, the Manager has extended the amount of Fund debt covered by interest rate hedges to ~90% of total committed debt.

Operational initiatives

Over the three months to 30 November 2023, the Manager observed year-on-year earnings[1] growth of 3.3% (like-for-like) and positive indications the operating environment is stabilising with venue patrons continuing to demonstrate their support for community pubs as an important part of the Australian lifestyle and social occasion.

The Manager has continued to focus its operating strategies on improving procurement outcomes, lowering direct expenses and maximising revenue through investment in effective marketing and promotional initiatives, underpinned by the performance of prior growth capital projects.

Earnings growth is fundamental to the ongoing success of the Fund and operational improvements, ongoing investment in venues to support growth, and potential recycling of capital into higher-yielding opportunities combined with a reduction in the Hotel Operator fees will assist in achieving this outcome.

Growth capital strategies

Over the course of 2023, the Manager has initiated limited growth capital projects due to liquidity constraints within the Fund.

The recent asset sales are expected to provide the Fund with sufficient working capital to reinstate its pipeline of growth capital projects that have the requisite statutory consent and an assessed target return of at least 15%[2] on capital invested in these projects, thereby supporting the Fund's earnings growth objectives.

The projects are predominantly cosmetic enhancements that the Manager expects to complete in reasonably short time frames while minimising venue and trade interruption. Subject to agreement with the Fund's lenders, the Manager proposes to invest approximately $20 million in growth capital projects within eight venues during the 2024 calendar year.

Management fee concession

In addition to its growth strategies, the Manager has agreed to reduce fees associated with the Hotel Operator Agreement by an annualised amount of approximately $4.3 million from 1 January 2024, equating to a one cent per unit cost saving for the Fund. This represents 40% of the Hotel Operator fees paid in the 2023 financial year and reflects the Manager's ongoing partnership with the Fund and its investors.

Any fees foregone because of the reduction will be waived and the Manager will review the Hotel Management Agreement fees associated with this agreement annually until the Fund's earnings exceed 10 cents per unit.

Distributions

The Fund has declared a distribution of 2.0 cents per unit for the December quarter. This represents a 15.0% increase on the prior quarter and demonstrates the Manager's efforts to restore distributions to its target of 10.0 cents per unit per annum and to continue to progress strategies to deliver further distribution growth.

Revaluations

As noted in recent investor communications, the Responsible Entity has reviewed the value of the Fund's portfolio to ensure the Net Asset Value (NAV) appropriately reflects market conditions.

Under this review, seven Fund assets were independently valued. These valuations, combined with the transaction data from the asset sales undertaken by the Manager and discussions with market participants, have provided a contemporary view of the market necessary to assess the value of the Fund's assets.

As a result, and in accordance with the Fund's valuation policy, the total Directors' Value for the Fund's portfolio has been revised to $1.3 billion, reflecting a blended portfolio capitalisation rate of 7.5% and a Directors' NAV per unit of $1.50. The reduction of the NAV relates primarily to increases in capitalisation rates which reflect the impact of rising interest rates on investment returns and is typical of the movement of asset values through a challenging economic cycle.

[1] Earnings refers to venue earnings before interest, tax, depreciation, and amortisation.

[2] The return on growth capital investment is the incremental EBITDA uplift over 60 months (including any downturn in venue trade during the construction period) divided by capital invested.

The Responsible Entity is satisfied the blended portfolio capitalisation rate of 7.5% reflects market conditions and equates to a fair valuation for the portfolio at this time.

Based on the revised unit price and assuming the 2.0 cent per unit distribution declaration noted above, as of 31 December 2023 the Fund will have delivered a total return of 13.1% per annum over the six and a half years since inception[3]. Over the same period, the S&P/ASX 300 Accumulation Index has delivered an average annual total return of 8.7%.

Quarterly Liquidity Facility

As noted above, a key objective for the Manager is the reinstatement of the Fund's quarterly Liquidity Facility so withdrawals from the Fund can be met in an orderly fashion. The Manager has worked diligently to implement a strategy for those investors who are seeking to redeem their investment in the Fund and acknowledges the ongoing frustration the liquidity pause creates. The recent asset sales provide a pathway to achieving this goal and as noted above, a portion of the proceeds from these sales are expected to be available to the Fund to apply to its working capital objectives.

The asset sales provide more certainty regarding the timing of the capital inflows that will assist the Fund in facilitating orderly withdrawals, however, the Responsible Entity has determined it is in the best interests of the Fund to extend the temporary pause of the liquidity facility by 94 days to 31 March 2024. This will provide time for the asset sales to settle and the Fund to receive the net proceeds. Accordingly, the Responsible Entity expects to reinstate the quarterly Liquidity Facility on 1 April 2024. This means withdrawals will be processed in accordance with the Fund's Product Disclosure Statement (PDS) in the June 2024 quarter.

As outlined in prior investor correspondence, the Responsible Entity is required to ensure withdrawals from the Fund are managed in an orderly and sustainable manner and, consistent with the provisions of the Fund's PDS, the Responsible Entity will aim to balance satisfying investor liquidity with the ongoing working capital requirements of the Fund. Therefore, and subject to a range of variables including venue performance, agreement with the Fund's lenders and the volume of equity inflows received by the Fund, the Responsible Entity expects to limit withdrawals during the 2025 financial year to approximately $10 million per quarter. However, this will be reviewed each quarter and the limit will be adjusted, up or down, to a level that the Responsible Entity determines to be in the best interests of the Fund and its investors.

More information

If you have any questions regarding your investment, please speak to your financial adviser or contact Client Services via clientservices@mafinancial.com or +61 2 8288 5594.

[3] The Fund's inception date is 10 July 2017.