

25 July 2016

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CIRCULAR TO INVESTORS

Dear Sir/Madam

RE: LM Investment Management Limited (In Liquidation) ACN 077 208 461 (LMIM) (the Company) as the responsible entity of the LM Australian Income Fund (the Fund)

I refer to my previous update regarding this Fund on 4 December 2015. I also refer to the appointment of Ginette Muller and I as Joint and Several Administrators of LM Investment Management Limited (In Liquidation) on 19 March 2013 and our subsequent appointment as Liquidators on 1 August 2013.

I provide the following update in relation to the wind-up of the Fund.

1. Closure of the LM Office

On 23 December 2014, the LMIM office on the Gold Coast was closed by the Liquidators of LM Administration Pty Ltd (In Liquidation).

As you might be aware, there are a number of insolvency firms involved with the winding-up of the various managed funds operated by LMIM. The books and records of each fund managed by LMIM are co-mingled giving rise to proprietary concerns should unrestricted access be provided to all parties involved. A Receiver was subsequently appointed to the books and records to resolve this issue through a Court sanctioned process. The Court ordered the costs of the Receiver be apportioned across the various managed funds involved.

On 29 January 2015, the Supreme Court of Queensland ordered that a copy of the LMIM server be provided to all insolvency practitioners concerned subject to strict privacy restraints.

A copy of the server was received during February 2015. Costs to re-host the server are material and are being apportioned between the managed funds remaining under LMIM's control. I am seeking to limit the costs to the Fund of re-hosting the LMIM server and I will limit the ongoing access as soon as it is not considered necessary for ongoing completion of the outstanding tax lodgements and financials.

2. Taxation Matters

As noted in my previous update, my office became aware of various outstanding taxation lodgement obligations of the Fund dating from 2012 onwards. I have recently requested transfer of the Fund's taxation matters from the Fund's former accountant to WMS Chartered Accountants (WMS), whom are appointed to also prepare the Fund's management accounts and financial reports. I will continue to work with WMS to resolve the issue of the outstanding taxation lodgements and I expect these to be brought up to date within the coming months.

Until these matters are resolved the Fund's final taxation liability cannot be confirmed. Accordingly, the outstanding lodgements may need to be satisfied prior to any final distributions to members. Please note an interim distribution will be made whilst the final liabilities of the Fund are being determined. Please see Section 9 of this report for further discussion.

3. Claim by the Receivers and Managers for the LM First Mortgage Income Fund (FMIF)

My office is currently assessing a claim against the Fund by the Receivers and Managers of the FMIF for contribution to operational funding of the LMIM office. The claim is in the amount of \$351,993 (excluding GST) for the period 26 July 2013 to 23 December 2014.

Further substantiating information has been requested on several occasions but is yet to be received. I note there was no contribution agreement in place with the Receivers and Managers prior to these costs, for which they are seeking reimbursement, being incurred. Whilst the claim is not yet agreed, on a conservative basis I have included the amount in my indicative net asset value at Section 8 of this report. The claim, if valid, will need to be paid from the assets of the Fund, if available.

4. Custom House Currency Exchange (Australia) Pty Limited (Custom House)

Custom House was a foreign exchange provider engaged by LMIM for each of its registered managed investment schemes. Although LMIM was "in the money" on its foreign exchange contracts for the Fund, LMIM was "out of the money" on its foreign exchange contracts for other registered managed investment schemes for which LMIM is the responsible entity.

As a result, Custom House sought to set-off the “out of the money” amounts owed by LMIM in respect of other registered managed investment schemes against the “in the money” amounts owed by Custom House in respect of the Fund, which included the following currencies:

Great British Pound	172.41
Swedish Krona	2,503,797.46

After lengthy negotiations to amicably resolve this matter in an attempt to avoid the costs and uncertainty involved with court intervention, I have recently reached an agreement in principle with Custom House for the release of the above foreign currency held for the Fund. The agreement is currently being formalised and I expect to recover these funds in the coming month. In this regard, I am also seeking advice in relation to the correct treatment and distribution of these funds once recovered.

5. Advisor Commissions

LMIM has historically recognised a liability for advisor commissions paid to advisors calculated as a percentage of funds invested in the Fund. These commissions were paid monthly in arrears and were brought to account on an accrual basis. The records of the Fund indicate commissions were paid up to (or around) our appointment date in March 2013.

I have now received advice the commissions are not payable as a proper expense of the Fund, and the advisors are to be treated as unsecured creditors of LMIM and may make a claim in the Liquidation. This means advisors’ commissions will not be paid in priority to the return of capital to members.

Should investors receive a claim for unpaid or accrued commission directly from their advisor, they should seek their own independent legal advice.

6. Audited accounts for financial years ended 30 June 2013 and 30 June 2014

As noted in my previous update, significant delays have been endured in relation to the completion of the audits for financial years ended 30 June 2013 and 30 June 2014, which has in turn delayed the final audit/s being progressed and completed. The finalisation of the audit had been initially delayed as a result of sourcing primary documentation to satisfy audit requirements which occurred primarily as a result of issues surrounding accessing server records following the closure of the LMIM office in December 2014. These issues were resolved by my office and I had expected the auditors to make significant progress when they recommenced their work in August of 2015. This did not occur to the level of

my expectations, and I am of the view delays since that time are solely the responsibility of the auditors.

In a recent meeting with the Australian Securities and Investments Commission (ASIC) discussions centred around these delays and the options moving forward to replace the current auditors and to expedite the finalisation of the wind-up of the Fund. In a separate meeting with the auditors, they have confirmed they are targeting 31 July 2016 for a completion of the 2013 and 2014 accounts. These accounts will be lodged with ASIC and provided to investors as soon as practicable upon completion.

Given the delays by the auditors, I have advised them they will not be appointed to complete any future audit work for the Fund. As part of this ongoing discussion I will be reviewing their outstanding fees given the delays that have been endured by the Fund. I am also in discussions with a new audit firm whom I believe will be better placed to work with the appointed accountants to complete the final audit/s in a more efficient and timely manner.

7. Remaining Fund Assets

There are two (2) remaining property loans of the Fund to be realised. A summary of the status of the remaining assets is provided below:

Western Australia – Residential land sub-division (3 lots)

The borrower defaulted on this loan and accordingly LMIM as agent for mortgagee took control to exercise power of sale. I note this asset was subject to a sales contract late last year however the buyer failed to settle and defaulted under the contract. I have recently concluded a further sales campaign and the assets are now under contract and due to settle on 27 July 2016.

The sale of these assets will not result in full repayment of the exposure of the Fund under the loan. Accordingly, I am also finalising my strategy in relating to the damages and costs claim held against the original defaulting purchaser. This avenue of recovery will be pursued only if it is considered in the best interest of investors to do so, having regard to additional legal costs that may be incurred.

Melbourne – Strata titled units (5 residential and 2 retail lots)

This loan was due to be recovered in April 2015 however delays have been experienced in relation to the settlements of off-the-plan sales as a result of construction issues. Since October 2015 there has been significant progress in the settlement of the residential units and in the reduction of the exposure under the loan, with over \$15.6m recovered in relation to this asset. The defaulting borrower currently remains in control of the loan security and has been managing the sale and settlements directly. However, recently progress appears to have stalled.

Based on the information I have to hand in relation to the value of the loan book security, this loan will be recovered in full including default interest payable under the loan. Should this not occur in a reasonable time frame I will consider my options in relation to recovering the remaining balance owed under this loan.

8. Indicative Net Asset Value

An indicative net asset value of the Fund as at 30 June 2016 is calculated as follows:

	AUD	AUD
Cash at Bank		21,695,962
Loan Receivables		<u>3,930,597</u>
		25,626,559
<i>Less: expenses of the Fund</i>		
Custodial Fees	(4,058)	
Accounting Fees	(5,300)	
Contingent Liabilities (including FMIF claim)	(378,675)	
Controllership Expenses	(28,336)	
Legal Expenses	(13,105)	
Taxation Liabilities	Advice pending	
Operational Expenses	(6,129)	
Liquidators remuneration and expenses	(160,742)	
		<u>(596,345)</u>
Indicative Net Assets as at 30 June 2016		<u>25,030,214</u>
Estimated Units AUD equivalent at 30 June 2016		40,229,577

Estimated Unit Price as at 30 June 2016	0.6222
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I note the estimated asset and unit values are expressed in AUD equivalents and are subject to daily market fluctuations. Accordingly they are subject to change without notice to members. I also note the expenses listed are excluding GST where applicable.

The above net asset position is calculated before consideration of future wind-up costs (including accounting and audit costs, and Liquidator remuneration and out of pocket expenses) not yet invoiced or yet to be incurred.

The net asset position is also subject to change should additional liabilities of the Fund be identified. As noted earlier in the report, I am in the process of determining the final creditor claims and taxation obligations of the Fund.

9. Timing for Finalisation and Distributions

On 17 December 2013, \$20 million was distributed to unit holders, equating to approximately 42.8% of the Fund based on an AUD equivalency at that time.

I was anticipating being in a position to make a final distribution to unit holders by mid-year 2016. However, given there are assets still to be realised and the process of determining the final creditor claims and taxation obligations of the Fund is not yet finalised, I propose to make an interim distribution of approximately \$16,00,000 AUD to unit holders imminently. This distribution, based on the estimate AUD equivalent unit holdings as at 30 June 2016, represents a distribution of approximately 39.77 cents in the dollar. These funds will be transferred via EFT as soon as possible. If your banking details have changed, please contact Advanced Share Registry (Advanced) urgently per the contact details below. Please include my office in any communication sent to Advanced.

The timing for finalisation of the wind-up of the Fund, including the final distribution, is currently unknown. As detailed in this report it will greatly depend on the resolution of the outstanding lodgements with the Deputy Commissioner of Taxation, the resolution of the unresolved claim against the Fund by the FMIF, the final realisation of the loan book security, and the completion of the final financial accounts.

I recognise investors are looking for a final resolution to this Fund and are working to complete the wind-up as expeditiously as possible.

Contact Details

Investors are able to obtain further information by either:

1. Updates will be provided on the LMIM administration website (www.lminvestmentadministration.com);
2. Sending an email outlining your queries to enquiries@lminvestmentadministration.com; and

3. Queries concerning transaction statements, holdings and updated details should be directed to Advanced Share Registry, the details of which are as follows:

- Telephone: +618 9389 8033
- Fax: +618 9262 3723
- Email: admin@advancedshare.com.au
- Address: PO Box 1156, Nedlands WA 6909

Yours faithfully
FTI Consulting



John Park
Liquidator