BLUE STAMP
COMPANY

15th October 2019

2019 Financial Year

Performance Measures

<u>2019</u>

While the 2019 financial year was our most volatile, the large price movements provided us with tremendous opportunity – allowing Blue Stamp Trust (Trust) to deliver a return of 35.54% (Lead Class units) before Performance Fees and 28.78% after Performance Fees (PF). A summary of the Trust's performance is provided below, with further commentary included in the Operating Review.

		Unit Price	Return
01-Jul-18		$3.7284	
30-Jun-19	Before PF	$5.0535	35.54%
	After PF	$4.8016	28.78%
Distribution per unit		-	
Closing unit price		$4.8016	

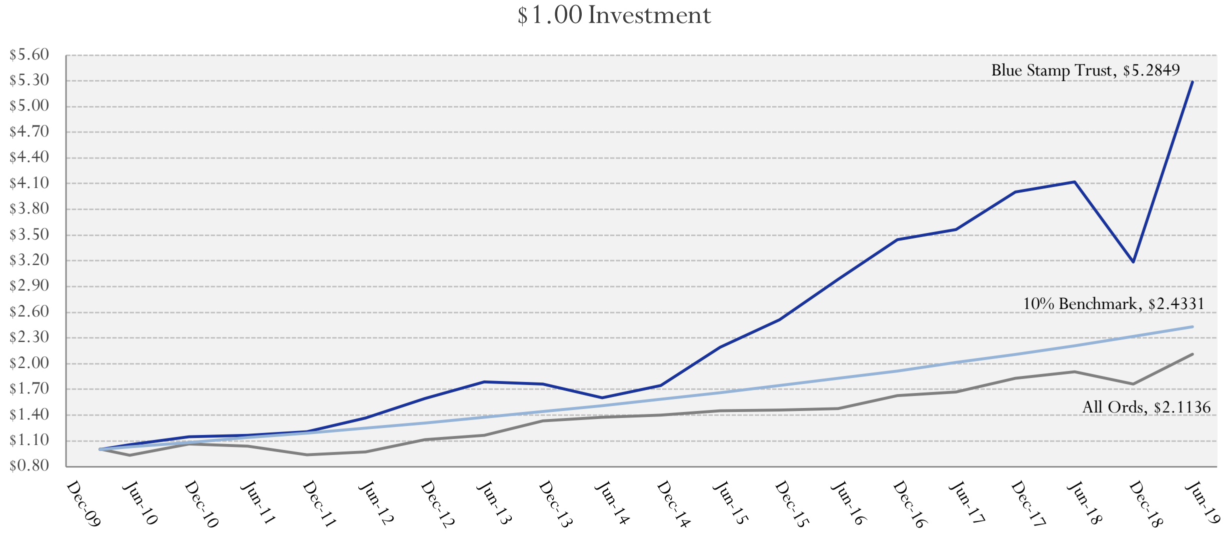
No distribution was payable for the 2019 year. Accordingly, the closing unit price at 30 June 2019 was $4.8016.

<u>Historical Performance</u>

Below is a summary of the annual percentage change of the Trust (both before and after Performance Fees) against the 10% Benchmark and the All Ordinaries Accumulation Index (Index) – the Trust's return for 2010 relates to the period from commencement on 2 March 2010, with the Benchmark being adjusted accordingly. The All Ordinaries Accumulation Index is used because it is the broadest measure of the Australian share market's performance whilst also including the effect of dividends.

	Blue Stamp Trust				Variance
Year	**Before PF**	**After PF**	**Benchmark**	**Index**	**(Trust vs Index)**
2010.......................	7.2	5.6	3.2	(7.3)	12.9
2011.......................	10.3	10.1	10.0	12.2	(2.0)
2012.......................	27.0	18.5	10.0	(7.0)	25.5
2013.......................	50.6	30.4	10.0	20.7	9.7
2014.......................	(10.8)	(10.8)	10.0	17.6	(28.4)
2015.......................	36.9	36.9	10.0	5.7	31.2
2016.......................	43.5	36.7	10.0	2.0	34.7
2017.......................	20.8	19.6	10.0	13.1	6.5
2018.......................	17.0	15.4	10.0	13.7	1.7
2019.......................	35.5	28.8	10.0	11.0	17.7
Avg Annual Return....	**24.3**	**19.5**	**10.0**	**8.4**	**11.2**

The following graph tracks the change in value of $1 invested in the Trust versus the 10% Benchmark and the Index. The value of the investment in the Trust is for *Lead Class units, after all fees and includes the reinvestment of any distributions*.



Viewing the return of the Trust against the Index should only act as a supplement in understanding the performance achieved in the prevailing climate. Instead, our main concern should be focused toward beating the 10% Benchmark over the medium term, by an acceptable margin.

As mentioned in prior letters, given that we are investors seeking longer term capital growth, we should eschew the short term and focus on performance over time horizons that are consistent with the period of our investment. Accordingly, expanding our perspective to include the entire history of the Trust, an investor at the Trust's commencement would have received an average annual return of 19.54% (after all fees).

As can be seen, we do not try to protect the Trust from short term volatility, instead relying on longer spans of time to reveal the merits of our investment decisions. However, recognising that we report over much shorter time frames, we should be prepared for continued volatility and negative years of performance, which I fully expect given the buoyant markets that are prevailing.

Manager Remuneration

The value of the Performance Fee was determined by the extent of the Trust's performance that exceeded the 10% benchmark. Importantly, with the Management Fee Rebate in place, the full amount of the Management Fee paid over the year has been applied to the gross Performance Fee and in so doing, reducing the Performance Fee payable to a net amount.

Fee	Description	2019	2018
Net Performance Fee	Cash ($)	1,151,708	129,742
(paid as)	Units^ ($)	-	147,109
	Total ($)	1,151,708	276,851
Management Fee	Amount ($)	228,033	159,941
(paid in cash)	% of net asset value	0.984%	0.968%

Amounts reflect the expense to the Trust – inclusive of Goods and Services Tax (GST) and Reduced Input Tax Credits (RITC).

^At the date of this report, the amount of Performance Fee paid in units had not been determined. More information is provided in the Operating Review below.

For 2019, the Management Fee rate was 0.984% of the average net asset value of the Trust, an increase from 0.968% in 2018. Despite the Trust's growth in 2019, the increase in Management Fee rate was due to Blue Stamp Company's (Manager) need to retain certain professional advice in anticipation of expected growth in 2020. While 2019's Management Fee rate is below the limit of 1.025% (including GST and RITC), we expect with increased scale, it will reduce in the years ahead.

No amounts other than those stated above were paid to the Manager from the Trust's assets over the year.

Operating Review

Income

The most significant components to the Trust's performance are the change in value of our long-term investments (both realised and unrealised) and any dividend income the Trust might receive. A summary of the Trust's income during the year is shown below.

	2019	2018
	$	$
Investments - Realised	(326,772)	1,702,629
Investments - Unrealised	9,183,555	1,323,026
Dividends	17,450	200,136
Other Income	11,855	9,076
Total Income	**8,886,088**	**3,234,867**

Investments

Returning to our expected dynamic, the Trust's performance for 2019 was almost exclusively driven by unrealised gains on our long-term investments – which saw a significant swing between the half year periods as follows; 1H19: ($3.5M), 2H19: $12.7M. As has been mentioned in previous letters, having our returns driven by unrealised gains, leads to efficiency in our performance – minimising transaction costs and taxes – and resulted in no tax distribution being payable for 2019, despite achieving a return of 28.8%.

Consistent with the second half skew mentioned above, the performance from realised investments also swung heavily between the periods; 1H19: ($1.7M), 2H19: $1.4M – resulting in total movements (realised and unrealised) in our investments of; 1H19: ($5.2M), 2H19: $14.1M.

Undoubtedly the Trust's second half performance was strong, made relatively more so by the fall we experienced in the first half. With almost every one of our holdings falling during the first half, we experienced a rapid turn-around, with nearly every position rising during the second half. During the 1H19 letter, we spoke in resolute terms, confident we had positioned the portfolio for what was expected to be a gradual retracing of the losses we had experienced at that time – though, how quickly the turn-around occurred surprised no one more than myself.

With meaningful volatility prevailing, the actions we have available to take advantage of those movements are, broadly; deploy any cash, draw on our margin loan, rebalance between holdings and/or invest any new capital. We undertook activity in all areas during 2019, with rebalancing the most significant factor.

Being presented with significant opportunities domestically and searching for funds to invest, we found an available pool of capital in our international holdings. Consequently, the portion invested in international markets fell to 2.7% of the Trust's net asset value at 30 June 2019 (2018: 15.2%). While our international holdings will continue to be an important part of the Trust's long-term performance, for now their proportion of net asset value is expected to remain below targeted levels (circa 10-20%) for the foreseeable future.

However, this rebalancing isn't to say that global opportunities are now lost to the Trust. The opposite is true. That is, for an organisation that offers a service with universal appeal, then by building it on a digital platform, technology can wrap the service around the world with speed that only 10-20 years ago was unimaginable. Importantly for us, nothing in this scenario requires the company to be domiciled in any particular region for the service to become globally relevant – so long as the company retains access to capital and suitably skilled labour. Fittingly, there are increasing instances of companies either listed or otherwise based in Australia (among other regions) that are seizing on their own global opportunity.

When a business with a global opportunity requires relatively little capital to sustain or grow its operations, vast sums of wealth can be built very quickly. 2019's volatility saw us rebalance the portfolio around those companies which we felt offered similar dynamics, including long runways of growth (and significant value), whilst also occupying a dominate competitive position – chiefly, these were Megaport and Afterpay.

While Afterpay is undoubtedly a business that is capital-intensive in nature, it nonetheless is rapidly scaling into their globally opportunity as they on-board large enterprise retailers, absorb accelerating inflows of new customers, all while maintaining the high levels of user experience that they are known for. Banning customers that default on their 'loans' and restricting the credit provided to those customers that frequently incur late fees engenders a 'self-healing' nature to Afterpay's underwriting over longer periods of time. This dynamic played out for the more mature ANZ region in 2019, where returning customers represented 97% of monthly orders for June and the cohort of Australian customers that were more than 3 years old were now purchasing more than 20 times per year – indicating the Group was experiencing higher transaction frequency, increased merchant sales and lower credit losses; driving significant operating leverage. Having launched in the far larger US market less than 18 months ago, Afterpay's US customers are already on a transaction frequency glidepath exceeding that of Australia at an equivalent maturity stage.

Afterpay enjoys a strong network effect whereby its deep pool of actively shopping customers is an attractive prospect to merchants looking to grow their sales (particularly to the younger demographics). As these merchants are drawn onto the Afterpay platform, it results in a wider footprint of shops offering the payment service, which expands customers further, which draws in more merchants, which expands customers further, which draws in more merchants, which expands customers further – increasing the RPM of Afterpay's flywheel.

There's little doubt Afterpay faces strong competition, especially in the larger markets it operates in. Though, a streamlined user experience and the widest range of integrated retailers help differentiate Afterpay. Additionally, having its service free for those that pay on time, helps limit any motivation for users to switch to another provider. Combine all this with a recent launch in the UK that at 15 weeks has matched the US and our appetite is whet for the years ahead.

Neither a software company nor an infrastructure company, Megaport's software-defined network is emerging as the global leader of data centre interconnectivity. Whilst requiring meaningful upfront investment to build their network footprint, once complete and an ecosystem in place, the company enjoys almost zero-marginal costs on each additional service sold. Similar to Afterpay's network effect, Megaport's deep pool of customers and cloud service providers draws in those data centre operators that want to build the ecosystem in their own data centres (and avoid becoming an island). This wider network of data centres expands customers further, which draws in more data centres, which expands customers further, which draws in more data centres, which expands customers further – and so spins Megaport's flywheel.

While Megaport also faces strong competition, being a global leader free of legacy operational debt, Megaport is best equipped to innovate and bring incremental value to its customers. One of the clearest markers of this success is in Megaport's cohort analysis, showing:

i. For each year of maturity a customer had been with Megaport, the cohort that had subscribed for the most services was the youngest cohort. For example, of the customers that had been with the Group for one or more years, those that had subscribed for the most services in their first year was the FY19 cohort (or the youngest cohort). Likewise, of the customers that had been with the Group for two or more years, those that had subscribed for the most services in their second year was the FY18 cohort (or the youngest cohort). This was the case for every year of Megaport's operations.

ii. Each financial year cohort shows a growing number of services per customer each year. By way of example, for the FY17 cohort of customers, the average number of services subscribed for in their third year exceeded the number subscribed for in their second year, which exceeded the number subscribed for in their first year.

All of this data indicates that Megaport's new customers are starting with more services each year and then layering on increasing numbers of services over subsequent years. Qualitatively, this paints the picture of a deepening ecosystem for Megaport and an ecosystem whose growth is bringing more value to those who use it.

Both Afterpay and Megaport are not only providing innovative new services and challenging incumbent operators/practices, they are also expanding the markets in which they operate – Afterpay through providing hybrid forms of credit and Megaport through opening up the data centre interconnectivity environment to beyond the four walls of any single data centre operator. Both companies are expected to continue to benefit from the ongoing development of these markets for many years yet – respectively, as buy now, pay later services become more widely accepted (by online and offline merchants, as well as more mature-aged customers) and as the cloud environment matures and deepens in complexity (with multi-cloud environments becoming the preferred architecture of increasing numbers of organisations). Potentially checking the runway ahead of both companies though will be the continued advancement in technology, something which both groups will need to invest in, to ensure they continue to lead the curve.

The strong share price performance of Afterpay and Megaport in the second half of the financial year acted to tighten our exposure around both companies. While we can always 'rebalance back', I feel that could prove to be very expensive behaviour, not only crystallising deferred tax liabilities, but also reducing the extent to which we participate in the ongoing development and progress of these companies. For Afterpay, the next three years will most likely be the most important years in the company's history in determining whether it does ultimately realise its goal of becoming 'the world's most loved way to pay'. If it lands anywhere remotely close to that target, then we are sitting on a significant treasure chest.

Strange as it may seem, elastic data centre interconnections don't produce the same trendsetting, viral-sharing social media habits as a fast fashion, beauty focused, buy-now-pay-later service targeted at female millennials/Afterbaes – omg. I die. lol. But seriously Afterpay slays. #truth (oh dear, I've become an Afterbae…). Accordingly, Megaport may have a little longer, perhaps the next five years will be crucial in determining its position in the global data centre interconnection market. Again though, given the size and strategic importance of this market, if the security, elasticity and functionality of Megaport's service sees it become the dominate global provider of interconnection services, then we own an asset with critical strategic importance and value to boot!

Despite having a concentrated portfolio, we will always be looking to add to it. Shortly into the new financial year, we kicked into gear as we sought to block a takeover bid for Silver Chef and in turn lead a recapitalisation of the Group's balance sheet. While Silver Chef was not necessarily a new holding for the Trust, our approach was. The idea was to remedy the solvency concerns Silver Chef was dealing with by injecting a large amount of new equity into the Group at a valuation that reflected those solvency issues. From that point, with the balance sheet stabilised, we were hoping to introduce a new governance and management structure to return the operations to growth.

While our recapitalisation proposal introduced more subordinated capital into the Group than the senior lenders originally requested and despite it being the only board-endorsed proposal on the table, it nonetheless failed to gain the necessary traction with the senior lenders for a number of reasons – some more influential than others… Without access to reasonable credit facilities, owning an asset finance company was a little difficult to justify. Accordingly, we were required to return to the same bidder which we blocked only three weeks prior and try to broker a deal.

This series of events did leave me scratching my head wondering what governance processes were being followed by those key stakeholders. Clearly, we were out maneuvered.

Motivating our actions around Silver Chef was a very large and attractive opportunity we saw for a specialist financial service provider and the possibility of building another long-term compounder for the Trust. Not all was lost though, as during this process a number of prospective opportunities were identified which we are now exploring. If anything comes of them, you'll hear about it in future letters.

Dividends

The decrease in dividend income in 2019, resulted from the Trust gravitating its holdings to those companies experiencing organic growth and in turn, were reinvesting capital into their operations. Critical to the long-term merit of this decision is how successful those companies will be at generating an adequate return on the retained capital. While we would never blithely suggest a company retain its operating cash flows, when their targeted rate of return exceeds ours it only makes sense for that to occur. Though we will be watching intently.

The dividend income shown above does not include franking credits.

Expenses

	2019	2018
	$	$
Investing Expenses		
Brokerage expense	(34,376)	(28,975)
Interest expense	(153,838)	(76,120)
Other expense	(2,257)	(1,363)
Total Investing Expenses	**(190,471)**	**(106,458)**
Management Expenses		
Management fee	(228,033)	(159,941)
Performance fee	(1,151,708)	(276,851)
Total Management Expenses	**(1,379,741)**	**(436,792)**
Total Expenses	**(1,570,212)**	**(543,250)**

Investing Expenses

Investing Expenses are costs that relate directly to securing and holding the assets of the Trust.

The most significant factor driving the amount of brokerage incurred during the year was the increase in market volatility, which caused a rebalance between our holdings. To a lesser extent, the allocation of new capital received into the Trust also contributed. For 2019, the average rate of brokerage paid on each transaction was 0.079% (2018: 0.090%).

Over the year, the Trust maintained an average leverage ratio of 22.7% (2018: 14.3%). The higher leverage we carried throughout the year and increased interest expense, was a result of our desire to scoop up as many shares as we could during the volatility experienced in the first half of the year. This required increasing the Trust's indebtedness to near our stated limit of 25% of net asset value.

The Trust's borrowings are incurred through a margin lending facility. The reason the Trust uses a margin loan is to allow it to maintain a fully invested portfolio – provided individual opportunities justify it. With the stock market rising on average over long spans of time, a fully invested portfolio (i.e. zero cash and zero borrowings) is our preferred state, with the margin loan providing increased liquidity when we feel the circumstances warrant the increased exposure and higher cost of funding. Obviously though, the market's performance in any one period may vary wildly, which is the reason for our relatively conservative borrowing limit. Certainly, when borrowings are used to finance an investment it is done with a clear understanding of the Trust's ability to service those borrowings through various market cycles and operating conditions, along with how the borrowings will be managed and paid down over time.

Following the end of 2019, a number of changes were made to how we calculate the Trust's leverage ratio[1]. The most meaningful differences came from reflecting the historical experience around how the Performance Fee was settled, and the recognition of subscriptions received in advance. Regarding the Performance Fee, in order for the Manager's shareholders to meet the tax liability generated from the payment of the Performance Fee, a portion (being 50%) is assumed as paid in cash – previously this was treated as entirely equity. For subscriptions

[1] Leverage ratio calculated as (total borrowings add liabilities: subscriptions received in advance, payables and 50% of performance fee provision; less assets: cash and receivables) all divided by net asset value including 50% of performance fee as equity, distributions payable as equity.

received in advance, no amount is assumed as being applied against outstanding borrowings – previously this was netted off. We consider these changes make the leverage ratio metric a closer reflection of the underlying dynamic of the Trust's assets, liabilities and cash flows. Accordingly, the Trust's leverage ratio at 30 June 2019 was 25.9% (2018: 26.4% as adjusted), which marginally exceeds our limit of 25% of net asset value.

Management Expenses

The Management Fee is the fee charged to manage the operations of the Trust, with any amount paid being rebated back against any Performance Fee accrued. If, over time, a Performance Fee is being earned by the Manager, then with the rebate in place, the only fee Unitholders are effectively paying is the Performance Fee – in this case, the Management Fee simply becomes an advance on any future Performance Fee. This helps ensure the Manager of the Trust will be adequately resourced whilst at the same time, maintaining the commitment to minimise the drag of any management expenses on the Trust's performance.

With the performance of the Trust being calculated after the payment of any Management Fee, it is in the interests of the Manager to keep any Management Fee as low as possible, as a lower Management Fee will lead to a greater return for the Trust and naturally, a higher Performance Fee.

The ratio of the Management Fee paid for 2019 as a proportion of the average net asset value over the year was 0.984% (2018: 0.968%) – marginally below the 1.025% limit (including GST and RITC).

By virtue of its structure the Performance Fee will only become payable when the Unitholder's equity (measured on a per unit basis) has increased by more than the Benchmark of 10% p.a. Following on, this fee would rightfully be considered a success fee as it represents the creation of absolute wealth for Unitholders.

As a large component driving the value of the Performance Fee was unrealised gains, an important feature of our structure is that the 'after tax' amount of the Performance Fee is paid in units of the Trust. This keeps the Manager on the hook for the quality of the Trust's investments and therefore aligned with the interests of Unitholders.

It is the Manager's intention to shield the Trust, as much as possible, from any expenses that are not the Management Fee or Performance Fee. Accordingly, all expenses incurred when pursuing the Silver Chef proposal were done so by the Manager (Blue Stamp Company), meaning that at the date of this report the amount of 2019's Performance Fee to be reinvested in the Trust had not been determined, as the Manager required those funds to be available to meet the remaining expenses of the Silver Chef proposal.

Net Income

	2019	2018
	$	$
Total Income	8,886,088	3,234,867
Total Expenses	(1,570,212)	(543,250)
Net Income	**7,315,876**	**2,691,617**

In line with the earlier discussion, the net income for 2019 led to a 28.78% rise in the Lead Class unit price to $4.8016.

General Discussion

Glory be to Unitholders

An indefinite investment horizon will be applied to investments made by the Trust – should their operational performance continue to warrant it and their valuations do not suggest an unacceptable contraction in our expected rate of return. We take this long-term approach because the period of time for the investment strategy to be realised is unknown and because this is the preferred holding period for a good investee company. That is, if a company is identified as a desirable investment – displaying earnings durability and growth – then it is preferable to maintain investment in this company even after any capital appreciation may have been achieved, as this is the most sustainable and scalable way to deliver compounded growth for the Trust.

While the mathematics of compound are unmistakable, the human mind is not well equipped to fathom it, preferring to identify patterns and extrapolate linearly. Bill Gates touched on this when he said, "We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten."

It's an incredible irony that the longest-lived assets, offering the greatest prospect (in terms of number and degree) for compound are offered in financial markets that are so ill equipped to fathom and measure compound. But therein lies the opportunity for those that are able to do so. Certainly, the Trust can take this approach not because of any particular skill of the Manager, but because of stability in the Trust's capital – through all market environments.

Having spoken of 2019's performance being made possible by the market's volatility (thanks for the tweets Donald), what hasn't been credited is the stability of the Trust's capital. While accelerating into dark clouds may be the best time to build our wealth, it will always come undone if we do not have a stable base of capital from Unitholders – where redemption requests effectively require us to sell when we would hope to be buying.

As is the case for every year of outperformance (but none more so than 2019), the Trust's returns should equally be attributed to the actions of Unitholders – who during 2019's market flux not only abstained from redeeming a single dollar, but instead *contributed* capital.

Just like any hungry athlete looks for an edge, having that patient capital underpinning the Trust, blesses us with a structural advantage before the starter's gun has even been fired. While our race still has a long way to run, unlike sport we don't need to be crossing the finish line first to ensure we walk away wealthy – though let's not drop the bar too low, a podium finish would be nice.

Luke Trickett