30th January 2020

Half Year to 31 December 2019

Performance Measures

The half year period saw Blue Stamp Trust rise 20.2% (after all fees) to $5.7708/unit for the Lead Class. If you hold units in classes other than the Lead Class, please login to your account to find the relevant pricing information.

A summary of the Trust's performance – before and after Performance Fees (PF) – is shown in the table below, together with a comparison to the 10% Benchmark and the All Ordinaries Accumulation Index (Index), the broadest measure of performance for the Australian stock market.

	Blue Stamp Trust (Lead Class units)		10%	
	Before PF	After PF	Benchmark	Index
01-Jul-19	$4.8016	$4.8016	$4.8016	69,326.90
31-Dec-19	$6.0514	$5.7708	$5.0416	71,813.87
Return	**26.03%**	**20.19%**	**5.00%**	**3.59%**

While a Performance Fee has been provisioned at 31 December, it's important to note that it is the Trust's policy to only pay the Performance Fee (if any) on an annual basis, after the end of the full year or on the redemption of units.

The following graph compares the historical performance of $1 invested in the Trust versus the Index and the 10% p.a. benchmark. The investment in the Trust is for *Lead Class units, after all fees and includes the reinvestment of any distributions which have been paid*.

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).

	1H 2020	1H 2019
	$	$
Investments - Realised	16,106	(1,691,102)
Investments - Unrealised	27,374,908	(3,506,271)
Short Term Transactions	-	757
Dividends	-	17,450
Interest	75,266	2,748
Total Income	**27,466,279**	**(5,176,418)**

Investments

Consistent with our objective of identifying and investing in companies that will compound our capital over long stretches of time, almost all our performance for the half year was driven by unrealised gains on our investments. And given our patient approach to allocating capital, the unrealised gains for the half year period were chiefly driven by Megaport and Afterpay. These are uncommon stocks producing uncommon returns.

The uncommon nature of these businesses comes from their global application and ecosystems. The cohort description for each company, provided in the 2019 annual letter, shows both groups are already benefiting from a customer lifetime value that is increasing as those customers use their services more.

The uncommon returns of these businesses is essentially the market recognising their long runway of growth and in turn, trying to value that profile of future earnings. Thankfully, having an absolute 10% as our benchmark means we can value that profile with sweet blinkeredness from factors such as monetary policy or market movements.

To pursue their growth, both companies made private placements of new equity during the half year – in no small part, to US-based investors. For Megaport, this will assist in rolling out their network to Japan (and eight other countries), as well as expanding in those markets where they already have a presence. Similarly, for Afterpay the new capital will allow the Group to build out their presence in new geographies sooner than otherwise. With both companies in a land grab, it's important they have the resources available to execute their ambitions as seamlessly as possible. Accordingly, we were comfortable to see the raisings take place and to participate where possible.

It's always interesting to watch the mergers, acquisitions, partnerships and joint ventures that pop up in any given vertical – helping to inform where value is being created, along with the strengths and weaknesses of the various players. Sticking to the verticals in which Megaport and Afterpay operate, some recent examples of this were Equinix's acquisition of Packet and PayPal's acquisition of Honey.

In January, Equinix – arguably Megaport's largest competitor – announced it will acquire Packet (not to be confused with another Megaport competitor, PacketFabric). Founded in 2014, Packet is a leading bare metal,

automation platform allowing enterprises an easier and faster path to deploying into locations that are closer to end-users (aka the network edge), while Equinix on the other hand is a global behemoth and clear market leader of colocation data centre services. Equinix's more than 200 data centres across 55 markets globally, emerged from a time when computing was centralised – growing up around key hubs of interconnectivity for the internet.

However today, with the development of new technologies such as 5G, virtual reality and autonomous vehicles (to name a few), the way data is used, where it is used and who it is used by, are all evolving – and often in a manner that requires data to be processed as close to the end-users as possible, in order to reduce latency and improve performance. The product of all of this is a more decentralised model that can cater to things such as edge computing and complex multi cloud and hybrid cloud deployments – again, allowing more data and services to be processed closer to end-users. Acquiring Packet will not only help push Equinix's footprint out to the network edge but just as critically, it will deepen their interconnectivity into the network edge.

But how is this relevant to Megaport? Being neutral of any data centre operator (such as Equinix), means that Megaport's service – of enabling near real-time provision of elastic interconnections between any given data centre (or edge location) to any given service provider means that it will always be in a position to provide a presence into more locations, whilst offering a deeper ecosystem of service providers. So if the world is indeed heading in the direction of a deeply interconnected, decentralised computing environment, where latency, network performance and rich ecosystems are critical components of success – as suggested by Equinix's acquisition of Packet – then presumably this places Megaport in the box seat to deliver the leading interconnection fabric.

Digital Realty (the second largest provider of colocation data centre services globally) seemed to have recognised early on that no one data centre operator would be able to be in as many locations and have as deeper ecosystem as an entity that was neutral to all. Consequently, in 2016 Digital Realty decided to enter a partnership with Megaport, whereby Digital Realty would use a white labelled Megaport service to offer their own interconnection fabric, called Service Exchange. Subsequent to this, Digital Realty took an ownership stake in Megaport, cementing the partnership further.

While time will be the ultimate arbiter, it's interesting to observe the approach of the world's largest and second largest data centre operators in dealing with the evolution of their industry – where the actions of both are suggesting the same conclusion but their means to get there is proving vastly different.

The payments industry is also not immune to the impact of technology, where incumbent providers are required to evolve their offering to ensure they continue to add value and remain relevant to both merchants and consumers. An example of this behaviour is shown in PayPal's acquisition of Honey – a deal-finding browser extension and mobile app – for US$4B in November.

With the internet initially offering retailers a market opportunity whose size was previously unimaginable, the development of an online shopping interface became critical to capturing that opportunity. However, absent trust in the payment provider, consumers were very reluctant to enter banking details to complete a purchase. Growing up at the same time as the internet meant PayPal was in the perfect position to provide this bridge of trust between the merchant and the consumer, allowing PayPal to charge merchants a toll every time a consumer used that bridge. Though with time and a generation of consumers that have only known what it's like to live in an always on, always connected world enabled by the internet, the authenticity of payment providers (who are now typically very large, well known brands) is largely assumed and any added friction to complete a purchase is insufferable to this younger generation.

With Honey, consumers have a seamless way to apply discounts and stay informed about where deals can be found; and because a customer with a coupon in their hand is more likely to complete an order, Honey therefore means, improved basket size and conversion rates for the merchant. Now, through its acquisition of Honey,

PayPal will be able to climb back up the chronological order of online shopping decisions, rather than simply competing at the final checkout page. These aspects of lead referrals and improving order metrics are critical elements for any online retailer to optimise and with trust having now been trivialised, Honey will help PayPal remain relevant to both retailers and consumers.

And how is this relevant to Afterpay? In addition to the benefits that Afterpay's interest-free credit offers merchants – being increased basket sizes and improved conversion rates – it also offers other means for demand generation. That is, Afterpay's user base of around 7M people, which is heavily skewed to those aged 35 years and under, means Afterpay has become a channel for merchants to access not just those mercurial, younger consumers, but those with a higher inclination to shop – which is retail gold! This resulted in Afterpay sending out over 10M lead referrals globally in October to its merchant partners, and in Australia, driving Afterpay to become the second largest source of leads for merchants, trailing only Google.

With the world of online advertising and lead generation consolidating around Google and Facebook, any additional channel to market that retailers may have is becoming increasingly valuable – not just from the perspective of economising marketing spend but also given the increasing frequency in which retailers are finding their advertisements being placed alongside inappropriate or otherwise offensive material on the platforms of Facebook and YouTube.

Combining all of the value propositions that Afterpay offers its merchants and consumers, it seems Afterpay is becoming a trusted place for consumers to *begin and complete* their shopping experience, along with a meaningful and safe place for merchants to engage with their target market. Or to put it in terms we used earlier, Afterpay is not only adding value to both sides of the transaction, chronologically, at the top of the decision tree (through lead referrals), but also at the bottom of the decision tree (the checkout) – and in so doing, differentiating itself from other payment methods.

So if PayPal's actions are signaling the need to deliver incremental value to merchants through improved demand generation and order metrics (rather than simply surety of transaction) then Afterpay's offering is beginning to place it as a critical player for both merchants and consumers alike.

Short Term Transactions, Dividends, Interest & Other

As it looks like the Trust has now received the final distribution from the Centrebet arbitrage transaction we undertook way back in August 2011, we can expect little to no income from short term investments going forward – as we remain laser focused on allocating our capital toward companies that offer compound, rather than one time free kicks.

The absence of dividend income was largely a result of the absence of profit at Silver Chef. Exiting some smaller holdings that failed to display the profile of earnings that we're looking for was the other factor that drove our dividend income to zero. As above, we can expect future income from dividends to be either small or zero, as a consistent characteristic of our holdings is the need to reinvest capital in order to fuel growth opportunities.

Interest income largely relates to capital the Trust was required to put aside in order to advance our Silver Chef proposal, though this income was offset by a comparable amount of interest expense – as we drew down on our margin loan to ensure we did not miss out on opportunities that became available while our funds were effectively escrowed.

At 31 December 2019, 1.5% of the Trust's net asset value was invested in foreign listed companies (1H19: 6.6%). The fall in our foreign holdings was due to the allocation of new capital invested into the fund toward

domestic opportunities – that is, we have not sold any of our foreign listed holdings. I hope and expect that over time our international holdings will increase again, as comparable opportunities are identified.

Expenses

	1H 2020	1H 2019
	$	$
Investing Expenses		
Brokerage	160,179	18,526
Interest Expense	75,309	76,763
Other Investing Expenses	1,351	1,108
Total Investing Expenses	**236,838**	**96,397**
Management Expenses		
Management Fee	704,899	96,384
Performance Fee	3,907,281	6,608
Other Fees	4	70
Total Management Expenses	**4,612,183**	**103,062**
Total Expenses	**4,849,022**	**199,460**

Investing Expenses

Investing expenses are costs that relate directly to securing and holding the assets of the Trust, of which drive the investment returns achieved. Specifically, Other Investing Expenses comprise market access fees – which the pared back service from Interactive Brokers passes onto us. While it is a little frustrating to pay these fees, the upshot comes from the far lower brokerage rate that Interactive Brokers charges, which overall, sees the Trust well ahead when compared to using other providers. However, our brokerage expenses did increase during the half, as we relied on a small number of brokers to assist us in building our holdings. Though with an average rate of brokerage paid on each transaction at less than 0.15%, our brokerage expense is still relatively small.

At the end of the half year, the Trust had borrowings equal to 13.0% of its net asset value (1H19: 27.9%). A large portion of these borrowings relate to the allocation of funds we expect to receive back from Silver Chef in due course, now that it's sold its main undertaking. Given Silver Chef has a large amount of tax losses and franking credits available, I do not expect to see these funds repatriated until the most tax efficient means has been determined by the Silver Chef board. Our margin loan (combined with our self-imposed limit) helps to balance circumstances such as this, so we may act decisively when we see an opportunity, without compromising our patience.

Management Expenses

The Management Fee is paid monthly and based on the net asset value of the Trust. Management Fees paid for the half year equate to 0.49% (2019: 0.50%) of the average net asset value of the Trust over the period. While this is in line with the annual 1% limit, with additional scale we hope to drive this fee as far below the 1% ceiling as possible – a dynamic that is now beginning to emerge.

As mentioned earlier, a provision has been made for the Performance Fee however no amount (if any) will become payable until after the end of the full year. Further to this, the Performance Fee provision includes a rebate for the full amount of Management Fees paid during the half year. This Management Fee Rebate further strengthens the alignment between the Manager and Unitholders and reinforces the Manager's focus on reducing, as much as possible, any fee that does not relate to the creation of Unitholder wealth.

Net Income

	1H 2020	1H 2019
	$	$
Total income	27,466,279	(5,176,418)
Total expenses	(4,849,022)	(199,460)
Net Income	**22,617,257**	**(5,375,878)**

The net income for the half year period drove a 20.2% increase in the unit price to $5.7708

General Discussion

During the half the Trust participated in a number of capital raisings and private placements, to support the growth ambitions of various companies – one new and three existing holdings. For companies with global operations, we're noticing a propensity to raise new equity from investors that are domestic to their largest market – which is frequently the US. This means a number of things for us, some good, some not so good.

Firstly (and most conspicuously) it's great to see our companies chase their growth and expansion opportunities, particularly in markets far larger than Australia. And while we would love for them to be funding this expansion from operating profit, we must also recognise these companies are relatively young and the absence of profit is partly what is driving our opportunity.

Another wonderful aspect about these companies raising equity from abroad is that it means they're getting more discerning about who they want as shareholders. With Australian institutions often suffering from a short-sighted and relative focus on performance, they rarely make good co-owners of a business that wants to make long term investment decisions. Accordingly, with an informed and stable base of shareholders on their register these companies have only improved their chances of success.

What's not so good about our companies looking offshore for capital is that it means your Manager has to work a bit harder – if there's an easy route, I'll take it! That is, not wanting to be cast under the same aspersion as being 'another Australian institution…' and not wanting to be forgotten about when companies look to much deeper markets to place capital, we have to make our 'pointy elbows' felt – which takes effort, right?!

Luke Trickett

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