

3rd December 2021

2021 Financial Year

Performance Measures

2021

Unexpectedly and off the back of FY20, where we clocked our highest return to date, Blue Stamp Trust (Trust) recorded a new ‘personal best’ during 2021, achieving a return for Lead Class units of 94.00% before Performance Fees (PF) and 69.65% after Performance Fees. But before you start giving me pats on the back, it’s worth pointing out that the market also delivered its best result (by a wide margin) since the Trust has been operating – our boat was certainly lifted by a rising tide. A summary of the Trust’s performance is provided below, with further commentary included in the Operating Review.

		Lead Class Unit Price	Return
01-Jul-20		\$7.4708	
30-Jun-21	Before PF	\$14.4930	94.00%
	After PF	\$12.6739	69.65%
	Distribution per unit	-	
	Closing unit price	\$12.6739	

No distribution is payable for the 2021 year. Accordingly, the closing Lead Class unit price at 30 June 2021 was \$12.6739. If you hold units in classes other than the Lead Class, please [login](#) to your account to find the relevant pricing information.

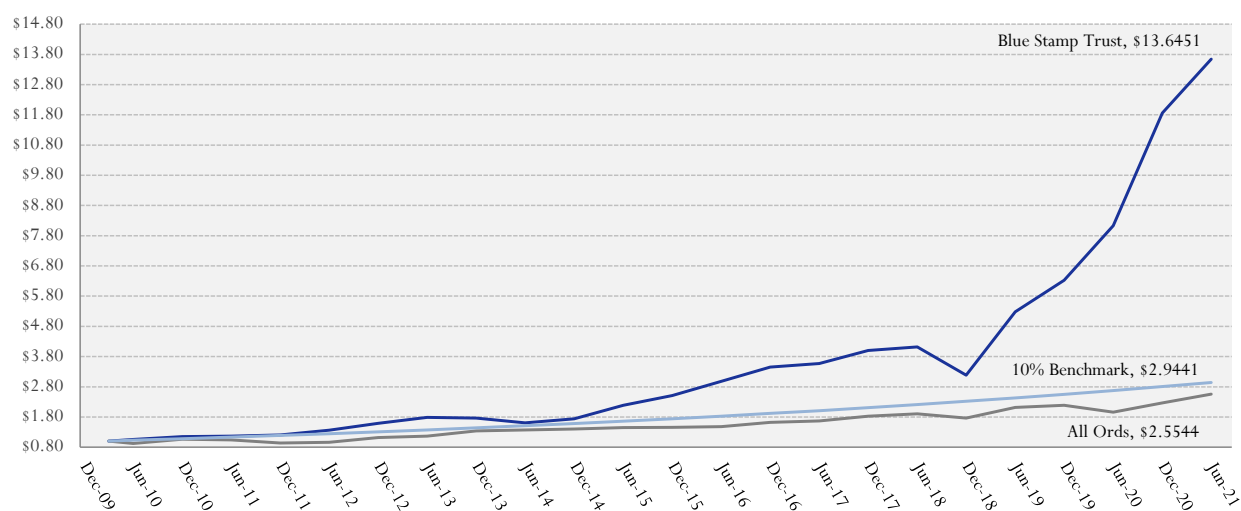
Historical Performance

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.

Year	Blue Stamp Trust		Benchmark	Index	Variance (Trust vs Index)
	Before PF	After PF			
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
2020.....	73.9	55.6	10.0	(7.2)	62.8
2021.....	94.0	69.6	10.0	30.2	39.4
Average Annual Return.....	33.1	25.9	10.0	8.6	17.3

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.*

\$1.00 Investment



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 25.95% (after all fees).

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, especially given the very strong performance of the Trust over recent years.

Operating Review

Income

The most significant component driving the Trust's performance is the change in value of our long-term investments (both realised and unrealised). A summary of the Trust's income during the year is shown below.

	<u>2021</u>	<u>2020</u>
	\$	\$
Investments - Realised	27,833,608	(24,129,665)
Investments - Unrealised	168,287,619	109,162,942
Dividends	68,949	19,319
Other Income	3,082	77,472
Total Income	<u>196,193,258</u>	<u>85,130,068</u>

Investments – Listed Equities

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. This approach also resulted in no tax distribution being payable for 2021, despite achieving a return of 69.6%.

If you're anticipating what interesting tidbits of information this section might reveal about how we achieved our best performance in over 10 years, then I expect you'll be disappointed – our secret weapon for 2021 was pretty much, just sitting still. There's little point kicking into action and trading cards when you're already holding the winning hand.

From the 'Investments – Realised' line item above, you might notice the little activity we did take was almost entirely weighted to the first half of FY21 – with over 93% of the sales made during the year, occurring in the December half. As mentioned in FY21's first half letter, those sales were from our holdings in Afterpay and Superloop, aiming to return the fund to a net cash position. Regarding our holdings in Megaport and NextDC, these remained completely untouched – save for one line of stock we purchased in Megaport.

Though this isn't to say we haven't been looking for new opportunities – but these things take time. Allocating capital is a process that has very long lead times (for us anyway), as we seek to identify companies which have a leading and differentiated position in a large market, so we can allow those companies and their operational growth, to grow our capital.

In the 2019 annual letter, we spoke about a couple of prospective opportunities that came from our recapitalisation proposal of Silver Chef. One of these was Marmalade, the other, PPK Group.

We purchased our first share of PPK Group in October 2019 and have been slowly building our research and knowledge since. However, during the year the Trust began to lean into its position as we saw significant inroads being achieved by the Group.

PPK Group is a commercialisation partner of Deakin University, helping to monetise the University's production of Boron Nitride Nanotubes (BNNT). BNNT Technology Ltd, a joint venture vehicle between PPK and Deakin, holds a 20-year exclusive licence over the BNNT manufacturing technology (with PPK owning a 50% stake in the JV vehicle).

BNNT is an advanced nano material that until now, had only been able to be manufactured at temperatures almost as hot as the surface of the Sun. Though, the electricity needed to heat something up to 4,000 degrees Celsius made the production of BNNT prohibitively expensive for any large-scale commercial application, with the nano material typically selling for ~US\$1,000 per gram – making the price of saffron look like a steal! However, the scientists at Deakin University, developed a process (over the past 10 years) that could produce BNNT at far lower temperatures and therefore far cheaper! And with properties such as being 100 times stronger than steel but only 1/6th the weight, heat resistant and radiation resistant, among others, the opportunity for 'BNNT-infused' materials is large. That is, when someone can make a metal alloy that is both lighter and stronger than any prevailing compound, the use cases of that metal alloy explode – with applications in defence, aerospace, health (dental implants specifically), and so on. And this is before considering their potential use in battery technology, where BNNT's resistance to heat and electrical insulation allow for a step change in battery efficiency to be delivered.

With such significant use-cases for BNNT, the most important factors to understand at this stage is not to accurately gauge the market opportunity (we know it's somewhere between large and enormous), but more around their ability to produce high-grade BNNT at a low cost and at scale – then allowing ample time for universities, industry and others to undertake research, testing, design and development, all of which is required before we see BNNT being widely injected into various components to improve outcomes.

In terms of our understanding of the opportunity, the 'low cost' and 'scale' dimensions are important, as BNNTs will in no small part, compete with carbon nanotubes (CNT) – which have similar, but inferior chemical and thermal stability¹. However, CNTs are able to be produced far cheaper than BNNTs (selling for less than \$1/gram for low quality material to over \$100/gram for high quality material), with global demand for CNTs in the thousands of tonnes per year, generating close to \$10b of revenue. By contrast, ~36kg of BNNTs were produced globally in 2018.

When we first started looking at PPK, the cost of each engine that produces BNNT was estimated to be at or below \$1m, with an expected useful life of ~4 years. One of these engines were estimated to produce ~1kg of BNNT annually, with the cost of the inputted raw materials being ~\$150 per gram. Now, the Group has reengineered the production equipment and is eyeing total annual manufacturing capacity of 500kg, with a workforce of 8 staff – meaning the Deakin / PPK joint venture by itself, can produce BNNT at cost that is likely well less than \$100 per gram, with annual volumes more than 13 times 2018's entire global production.

However, it will take time for industry research to identify how and where BNNT may be infused to improve outcomes and certainly with such a large increase in global production, the unit cost of BNNT will undoubtedly fall – but as a PPK shareholder, that is exactly what we want (and need)! Because with a cheaper price, the material can be considered in wider use cases, by more organisations, which only expands the market opportunity for PPK.

The quality or grade of BNNT being produced by BNNT Technology Ltd (the Deakin / PPK joint venture) was the third important dimension for us to understand at this point. To test this, over the course of 2020 we ordered samples of BNNT from five of the most notable manufacturers around the world – including those based in the US, UK, Canada and Australia – with the aim of comparing the quality (in terms of grade and purity) of each of

¹ Harrison, H. et al. (2019). Quantification of hexagonal boron nitride impurities in boron nitride nanotubes via FTIR Spectroscopy. Royal Society of Chemistry

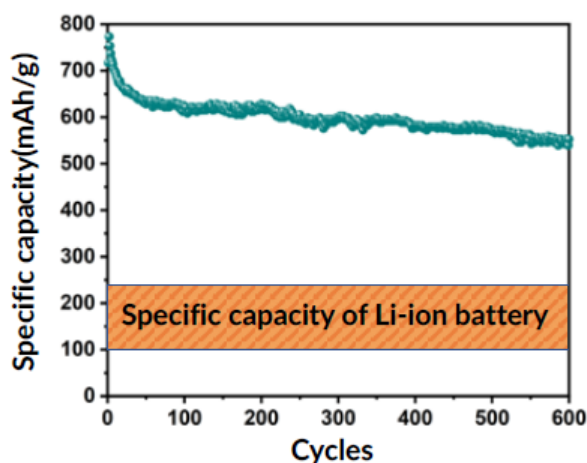
their samples. After finding an independent organisation (UNSW) that had the skills and equipment to measure material down to an atomic level, it turns out that what's on the label is not always in the tin! It seems the Royal Society of Chemistry had a similar experience, concluding 'some BNNT providers offer "purified" materials, however purity claims are weakly supported².'

Thankfully though, our friends at Deakin were true to their word, as the sample from BNNT Technology Ltd, clearly demonstrated the highest grade and purity of BNNT. So alarming was the degree of misrepresentation by the other manufacturers, Deakin contacted Blue Stamp to obtain a copy of the report and PPK used it to publish a redacted version to the ASX on 10 September 2020.

In addition to simply selling BNNT to all and sundry, PPK is also building ownership interests in ventures that can use BNNT in their respective operations – allowing PPK to firstly benefit from selling BNNT to the venture and secondly, to participate in the value created from producing goods that deliver new functionality and capability from the BNNT – with the latest being battery technology, through its interest in Li-S Energy Ltd.

Li-S Energy is a privately held venture that was co-owned by Deakin University and PPK Group, focused on commercialising lithium sulfur (Li-S) batteries. Li-S batteries have a number of significant advantages over their lithium-ion counterparts, not least of which include, cheaper raw materials that are less toxic and more abundant, whilst also carrying more charge for each kilogram of weight than the current widely used, Li-ion batteries. However, lithium-sulfur batteries have yet to be mass produced, suffering from the challenge of optimising and stabilising the battery components during charge and discharge cycling. Specifically, lithium-sulfur batteries tended to fail after a low number of recharge cycles, making them of little use for most commercial applications. Accordingly, Li-ion batteries have come to dominate the global rechargeable battery market.

Li-S Energy's research and development has shown that integrating BNNTs into lithium-sulfur battery components and architecture is an effective method of stabilising the battery components during charge and discharge, creating a lithium-sulfur battery cell with a cycle life approaching that of everyday consumer grade lithium-ion batteries, whilst maintaining specific capacity at greater than 550mAh/g – which is in the region of three times the specific capacity of current Lithium ion batteries (shown in the chart below). Meaning Li-S Energy's batteries are lighter, safer, faster charging, have greater energy density and use more environmentally friendly raw materials, thanks to BNNT – providing the means for significant improvements in many battery-operated products (for example, electric vehicles with a range of 1,000 kilometres or mobile phones that remain charged for a week). Li-S Energy is now working toward commercialising and mass-producing lithium-sulfur batteries.



PPK Group announcement, 18 May 2021

² Harrison, H. et al. (2019). Quantification of hexagonal boron nitride impurities in boron nitride nanotubes via FTIR Spectroscopy. Royal Society of Chemistry

The Trust recorded its first holding in Li-S Energy in December 2020, when PPK spun out its interest in the venture as they prepared it to be floated on the ASX.

While PPK and Li-S Energy are taking us into a new industry – advanced manufacturing – it does not mean we have wrenched on our commitment to stay laser focused on industries we know. Instead these demonstrate the iterative nature of our investing, where prior work and insight from an existing holding reveals the opportunity for a new potential holding.

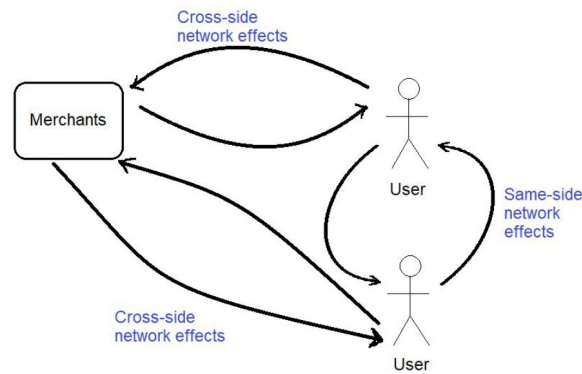
Also of note, in August the New York Stock Exchange listed Square made an all-scrip offer to purchase Afterpay – one of the Trust’s core holdings. We’ve been thinking about Afterpay’s progress to sustainably differentiate their service for some time, so with the two networks that the combined entity would have, we can immediately see the value in Square and Afterpay joining forces.

From Afterpay’s perspective, their powerful growth was driven by the cross-side network they built, which essentially is a fancy way to describe the network of merchants that a consumer could shop at and pay with Afterpay. Such is the demand from consumers for Afterpay’s service, merchants are compelled to make it available, which helps drive the acquisition of more consumers and so on. While this dynamic has been challenged in more recent times with an influx of competitors, Afterpay continues to drive significant volumes of demand to merchants, with its store directory sending ~1M leads globally to merchants each day. Accordingly, the value to an e-commerce merchant in Afterpay’s store directory is clear – with Afterpay bringing shoppers with intent to merchants that are hungry to sell.

From Square’s perspective, with more than 70 million consumers using their peer-to-peer payment service (called Cash App), they enjoy a strong same-side network (where one user gains more value in the service as more of their friends join), but lack a cross side network, despite the millions of merchants that use Square and Cash App as their point of sale terminal.

So while Afterpay and Square both possess strong bases of merchants and consumers, they have each linked these in very different ways (Afterpay being cross-side and Square being same-side). Further to this, the two businesses compliment each other through the differences between each of their consumer and merchant bases. That is, Afterpay’s consumer base is global and underrepresented in Cash App’s user base, which is largely US-centric. There is also little overlap in each of Square’s (including Cash App) and Afterpay’s merchant base, with Square’s profile of merchants weighted to small, offline businesses while Afterpay enjoys a strong merchant network in enterprise size, online retailers. Given Square is wanting to expand into large online retailers and Afterpay is looking to extend their reach into offline merchants, the opportunity for the two of them to come together is again, compelling.

Accordingly, Afterpay will help Square build a cross-side network (with complimentary merchant ecosystems already in place), improving the monetisation of Cash App, whilst Cash App will bring to Afterpay a new and significant form of differentiation in its same-side network – helping to provide Afterpay with a durability that it has not had to date, through being part of a multi-sided network (shown in the diagram below) – as well as bring significant opportunities for accelerated growth and monetisation.



The presence of Cash App’s wallet will also be attractive to dovetail into Afterpay, as a user’s BNPL repayments will no doubt first be deducted against the Cash App user’s wallet for little to no transaction processing fee. And with transaction processing costs such a large factor in Afterpay’s net transaction margin in the US, the opportunity to reduce costs and deliver immediate, tangible value is material. Though as always, time will tell how much value can be delivered from all of these opportunities.

Investments – Marmalade

We are not building a financing or factoring business with Marmalade. We are building a payment rail for invoices. Many components go into a payment rail, ensuring funds accurately flow from one party to the other in a timely manner. Using the example of a consumer purchasing a pair of jeans online, some of the components for the *consumer-side* of the transaction may include, a debit card issued by their bank, the Visa, Mastercard or EFTPOS payment network, the consumer’s bank account and of course the consumer’s money. The *merchant-side* of the transaction also has numerous components to ensure the funds land in their bank account, but we’ll save that for another example. In this case, when the consumer inputs their card details and completes the order, the payment network matches the card details with the consumer’s bank account, debits the bank account in real-time for the amount of the order, with the funds being remitted to the merchant immediately.

With card payments being ubiquitous, a merchant selling to a consumer rarely, if ever, has to wait for their payment, which is made in full (less transaction processing fees) – also meaning the merchant carries no exposure to the customer’s creditworthiness. This does not change when considering other payment systems such as PayPal or even BNPL providers such as Afterpay (though some competitors to Afterpay do allow the merchant to wait for payment, in return for a lower transaction processing fee – but again, we’ll waive that away for now).

While consumer payment rails are well established and accepted, business-to-business (B2B) payments have a very different dynamic, remaining disintermediated, with suppliers and payers having a direct relationship and consequently, no independent rail existing for these transactions.

The absence of a payment rail exacerbates other underlying issues for B2B transactions, which are largely three-fold. Firstly, to make a sale, the supplier of a good/service typically has to provide their customer with interest free credit (e.g. 30-day payment terms) – this should ring a bell... in the consumer world it’s called Afterpay. Providing trade terms not only plays havoc with the supplier’s cash flow, but it also introduces the second issue, whereby the supplier is now exposed to the credit risk of their customer while they wait for payment. Which brings us to the third (and most unfortunate) issue, being customer-initiated payments, where the supplier has no means to effect payment of their invoice – compounding the supplier’s exposure to their customer’s credit risk (second issue).

Furthermore, with almost all B2B payments occurring over bank transfer, the supplier is completely at the mercy of their customer deciding when, how much, to who and with what identifying description the payment is made. And on the other side of the transaction, the customer wears all the risk of the payment being directed to the wrong (or fraudulent) bank account. While some B2B payments occur over card and an even smaller amount via direct debit, all these do is make the payment travel faster (in the case of card payments) or improve the ability to identify and reconcile the payment – they do nothing to empower the supplier, with almost no B2B payments being supplier-initiated.

At large, no amount of digital innovation will change the need for suppliers to offer trade credit (because the customer wants flexibility over their cash flow and the ability to decide when payment will be made, and the supplier needs to make the sale), nor would it change the practices of customers paying via bank transfer (the means of payment that offers the most control for the customer).

Accordingly, Marmalade has built its product to be aligned with these existing practices – knowing that suppliers offer terms to their customers and those customers will most likely pay via bank transfer (though we do still accept payments via card or direct debit). Starting at our integration with Xero, a supplier using Marmalade as the payment service on their invoice, does not need to introduce a new process or workflow when they are creating and issuing invoices to their customer – they can continue to use the accounting software they always have, whilst also provide terms to their customer in a manner that suits their business without needing to gain approval from Marmalade. Likewise, from the customer’s point of view, aside from initially updating the bank details (to now pay the supplier’s new bank account), there are no other changes required in their process – they can continue to pay using bank transfer according to their internal payment cycles, they do not need to ‘sign up’ to Marmalade or provide Marmalade with any of their financial information for the supplier to be able to get the full value of Marmalade.

So with as little disruption to existing processes as possible, the supplier now has a rail for their payments to flow over and with this in place, they can rely on Marmalade to process their payments as customers pay, or, enabled by Marmalade’s proprietary technology and data, the supplier can issue an invoice to their customer and see it appear in real-time in their Marmalade portal and elect to have those eligible invoices cashed-in, immediately after issuance, for a low, one-time fee – shifting the power of payment from the customer to themselves.

Cashing-in an unpaid invoice is the only time a supplier pays to use Marmalade, with all other payments processed (and automatically reconciled in the Supplier’s Xero account) for free – though a surcharge is applied for any payment that is made using a credit or debit card. If a cashed-in invoice is paid late or the customer defaults and cannot pay, there are no other fees, charges, interest or penalties levied on the supplier or their customer. Rephrasing this, for cashed-in invoices, Marmalade’s credit risk lies with the payer of the invoice, not the supplier (the payee) – consequently, when a supplier signs up to Marmalade, it is not an application for credit, we are not assessing their ability to repay a liability, instead they are applying for a digital payment service and cash flow tool. The pleasing result of all this is when a supplier pays to use Marmalade, they are receiving an injection of cash and the removal of risk, leaving their business in a stronger position.

Marmalade creates cash flow, not debt.

Building on this, there is no commitment or contract that obligates suppliers to use Marmalade for any period of time – ensuring Marmalade is not only free to use as a payment service, but that it remains flexible for our suppliers, allowing those who do not see its value to leave whenever they wish. This dynamic is entirely consistent with our intention to build long term partnerships with our suppliers, partnerships based on voluntary adoption rather than lock-in contracts, a partnership that empowers suppliers with complete control of their cash-flow, receiving Payment on Demand – delivering operational improvements and accelerated growth to

their business. Or, in the words of one of our suppliers who operates in the building industry, Marmalade has turned their business “into a ‘cash register’ business, overnight”.

Pleasingly, Marmalade’s service is one that’s not only available to larger suppliers with armies of employees, thousands of invoices and millions of dollars to cash-in, but also for the micro business, where having the ability to cash-in a single, low value invoice provides them the support that they could not find anywhere else.

If it’s not clear, Marmalade is an invoice payment service first and a cash flow tool second. Put differently, our invoice payment service is what enables us to deliver Payment on Demand, whilst also positioning Marmalade as a structural component to our supplier’s operations, rather than a modular component that can be swapped out with any other alternative – providing the potential for a wide competitive moat in the years ahead.

The table below shows a summary of some key quarterly metrics as at 30 September 2021 – a full year since Marmalade commenced operations on 1 October 2020. During this time, we have continued to better understand the business and consequently have adjusted the definition of an Active Supplier from one which in the last twelve months, Marmalade has either processed a payment for or who has cashed-in an invoice, to now being, *a Supplier who in the last 30 days has issued an invoice with Marmalade as the payment service*. We feel this new definition improves the quality of data, aligning the definition of Active Suppliers more tightly to our vision to be the protocol for invoice payments – capturing those suppliers that are engaged with our service, whilst filtering out any that quickly disengage. For example, a business that is in desperate need of cash, may be highly motivated to sign up and cash-in an invoice, but then subsequently lose engagement and not continue to issue invoices over Marmalade’s payment rail. Previously we would have been counting that business for a full 12 months in our Active Supplier definition, even though they have stopped issuing invoices over Marmalade and would not be able to cash-in any invoices in the future. Whereas the other extreme is a supplier that hasn’t cashed-in an invoice but has unfailingly issued every invoice over Marmalade’s payment rail – this supplier is certainly active as we process all their payments and they have positioned themselves to have the greatest number of invoices eligible to cash-in (whenever they may choose to do so).

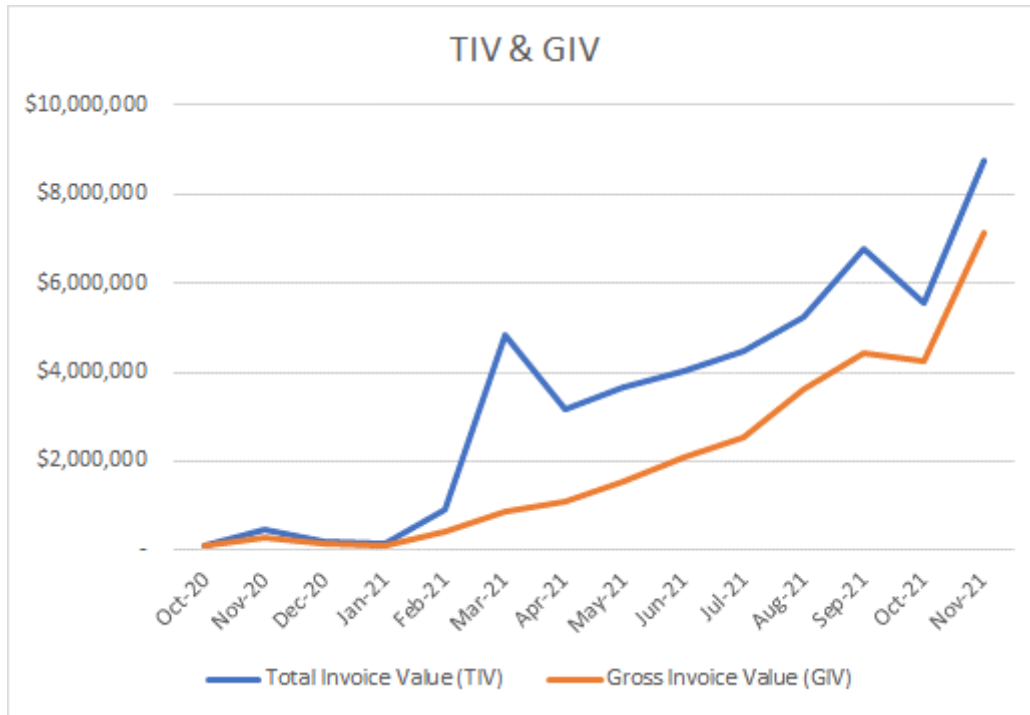
	Dec-20 Qtr	Mar-21 Qtr	Jun-21 Qtr	Sep-21 Qtr
Active Suppliers*	5	16	22	34
Gross Cash-in Value (GCV)	\$209,077	\$402,140	\$2,793,808	\$4,745,537
Received (\$)	\$209,077	\$400,413	\$2,765,462	\$3,753,239
Receivable (\$)	-	\$1,727	\$28,346	\$992,298
Invoices Cashed-in (#)	23	54	739	1,187
Avg. Cash-in Value	\$9,090	\$7,447	\$3,781	\$3,998

*Active Suppliers - A Supplier who in the last 30 days has issued an invoice with Marmalade as the payment service.

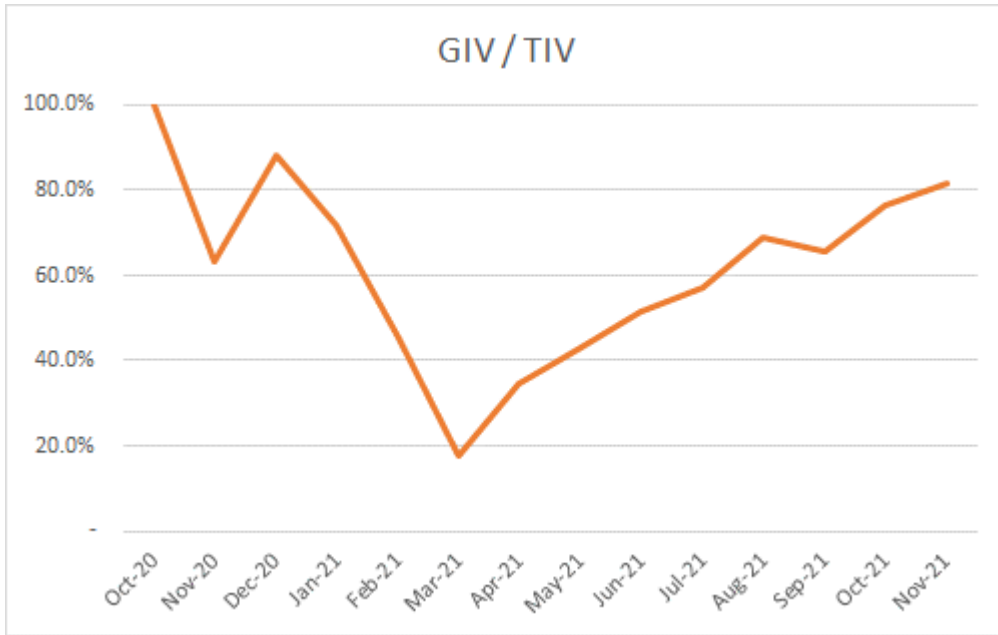
In order to build a deeper understanding of what supplier engagement looks like, it’s helpful to define some parameters. Firstly, after a supplier becomes active (that is, they have issued their first invoice using Marmalade’s payment rail), then all subsequent invoices they issue (whether using Marmalade or not), while they remain active, are counted toward the supplier’s Total Invoice Value (TIV). Across the group, TIV represents the highest-level metric of the size of the opportunity from our Active Suppliers. From TIV, our aim is to ensure on a supplier-by-supplier basis, the greatest number of invoices are issued over Marmalade – with this metric defined as Gross Invoice Value (GIV). GIV is important as it’s a prerequisite for an invoice to be cashed-in (that is, an

invoice must use Marmalade’s payment rail for it to be eligible to be cashed-in), and a leading indicator of revenue. A third parameter, Gross Cash-in Value (GCV) represents the gross value of invoices that are cashed-in.

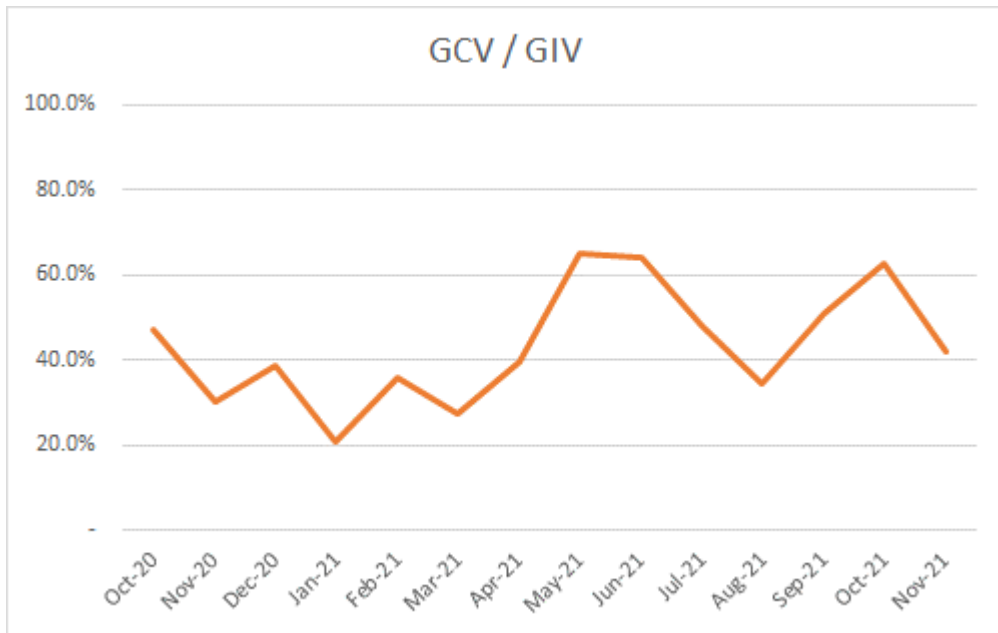
Using these metrics, we can see the Group’s TIV and GIV have been steadily rising since October 2020, as shown below.



Building on this, the GIV/TIV ratio, shown in the chart below, is the most effective way to see how engaged our Active Suppliers are and how embedded Marmalade is in their operations. From the Group’s perspective, we aim to drive this ratio toward, and as close to 100% as possible – if this is achieved, we know that Marmalade is the only payment method at ‘checkout’ across our entire base of suppliers, and so we’re the only option to cash-in an invoice (a commanding position to be in, especially when we consider the analogue in e-commerce, where there are a multitude of payment choices competing for the consumer’s attention at the checkout).



Then finally, the ratio of GCV/GIV is a measure of how heavily the cash-in service is being used. As shown below, this metric is very strong (and far higher than I initially thought would be achieved), however I expect it to fall in the years ahead, as our current performance is being skewed by a small population size and our targeting those industries and suppliers that we think have the greatest cash flow challenges and so, the highest need for Marmalade.



We have learned a great deal over the past year, not least of which is how malleable invoices can be – with changes to almost every variable not just possible, but probable! This has refined who our target customer is, especially in these early days as we develop the product’s capability and as our risk framework matures, ensuring we can remain flexible, so we can adjust as our suppliers need to adjust, but without compromising the safety of Marmalade’s capital.

This learning has caused our new customer acquisition strategy to stop and start a couple of times, as we recalibrated who we should target. Though as the business develops, we will be able to widen our net and empower more Australian businesses with Payment on Demand.

To continue executing on the opportunity, Marmalade raised additional funding, largely from existing shareholders in May and June. The new equity capital was raised by Marmalade at a valuation of \$1.15 per share, or \$8.6m pre-money. This raising is expected to provide 12 months of funding for Marmalade to continue to grow its operations.

The Trust took up its proportional entitlement in the capital raise, which saw the cost base of its investment in Marmalade at 30 June 2021, rise to 3.5% of the Trust. However, as requested by the Trust's auditor for the 2021 financial statements, Marmalade was valued by an independent expert in parallel to the capital raising, with the midpoint of the independent expert's valuation coming in at \$0.98/share. Accordingly, the Trust's investment in Marmalade was written down from a share price of \$1.15 to \$0.98, to reflect the independent expert's valuation. This write down saw Marmalade contribute an unrealised loss of 0.7% to the Trust's FY21 performance, with Marmalade's book value comprising 3.8% of the Trust at 30 June 2021 (2020: 2.1%).

Investments - Backpacket

A direct result from our work with Marmalade and building on our research of other companies over the years, we identified what we felt was an attractive opportunity to develop a consumer payment service that was based on more than a payment. A service that not only enjoys same-side and cross-side network effects (like a combined Cash App and Afterpay) – powering user growth and merchant adoption – but one which delivers new payment functionality that could reinforce those two network effects.

While patient allocation of capital is a simple concept, it has a powerful impact when investing in equities – and it's been the foundation for our investment decisions and performance over the years. Building from that foundation again, on 9 July 2020 the Trust founded Pixel Payments Pty Ltd (trading as [Backpocket](#)) to first explore, then execute the opportunity identified in the consumer payments sector. Consistent with Marmalade, Backpacket enables the Trust to put a small amount of capital at risk to potentially participate in a large profile of future earnings. And consistent with Marmalade, I do not personally hold any shares in the venture, nor do I receive any remuneration from the venture. My personal economic interest in Backpacket will flow when value first flows to Unitholders.

Backpocket released the first version of its product on iOS and Android on 23 August 2021, with this v1 consisting of a free, real-time, peer to peer payment service. While we are only a few months in, if we can demonstrate the acquisition of users, who in turn draw in their own networks, then there is a long runway of functionality to deliver to monetise the service, all of which aim to drive further user acquisition and engagement and reinforce the two networks.

So, while Backpacket has started life as the most basic version of itself – a P2P payment service that tracks the ongoing tally between friends – this is simply the opening play in a game that has decades to run, an initial gambit to build a differentiated product that delivers unique value to our users, drawing in their network and positioning Backpacket as distinct from every other payment service. All of which lays the foundation for a durable stream of earnings for Backpacket and an attractive profile of potential returns for the Trust.

At 30 June 2021, the Trust's investment in Backpacket was 0.8% at cost and book value. Accordingly, Backpacket contributed nil realised or unrealised gains during FY21.

Dividends and Other Income

Dividend income is increasingly a marginal contributor to the Trust's performance, and we expect this to continue as our investee companies remain squarely focused on investing all available capital to best position themselves as a leader in their respective markets. Critical to the long-term merit of the decision to reinvest for growth is how successful those companies will be at generating an adequate return on the retained capital. While we would never flippantly suggest a company retain its operating cash flows, however when their targeted rate of return exceeds ours, it only makes sense for that to occur. We will be watching closely.

The dividend income shown above does not include franking credits.

Other Income relates to interest received on our cash holdings throughout the year.

Expenses

	<u>2021</u>	<u>2020</u>
	\$	\$
<u>Investing Expenses</u>		
Brokerage expense	(56,167)	(231,648)
Interest expense	(32,908)	(174,699)
Other expense	(2,344)	(2,690)
Total Investing Expenses	(91,419)	(409,037)
<u>Management Expenses</u>		
Management fee	(2,951,181)	(1,520,324)
Performance fee	(31,609,629)	(12,878,506)
Total Management Expenses	(34,560,810)	(14,398,830)
Total Expenses	(34,652,229)	(14,807,867)

Investing Expenses

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

Our trading activity during FY21 was significantly down on FY20, which drove the reduction in brokerage expenses over the year. For 2021, the average rate of brokerage paid on each transaction was 0.090% (2020: 0.118%).

Over the year, the Trust maintained an average leverage ratio³ of 3.2% (2020: 8.2%), which is meaningfully lower than our previous history. While higher valuations are cheered by most investors, invariably, all they do is pull forward investment returns from future periods and in doing so, increase the risk of holding the asset – should it fail to meet the market's ever higher expectations (let alone absorb any unforeseen shock). Consequently, amplifying our exposure through leverage is amplifying our exposure to higher expectations. While we have never invested a dollar of capital based on general market movements, but instead the fundamental drivers of specific opportunities, the extent (or lack thereof) of the Trust's leverage, reflects the

³ Leverage ratio calculated as total borrowings add liabilities (including 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 and removing the book value of any privately held investment).

difficulty in identifying compelling individual opportunities in the current market environment. The Trust's leverage ratio at 30 June 2021 was 8.4% (2020: 12.7%), which is below our 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. However as we know, the market's performance in any one period may vary wildly, so we maintain a relatively conservative, self-imposed borrowing limit. Certainly, when borrowings are used to finance an investment it is done with a clear understanding of the Trust's ability to maintain and service those borrowings through various market cycles and operating conditions, along with how the borrowings will be paid down over time.

Management Expenses (Manager Remuneration)

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 our 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 2021 to the average net asset value over the year was 0.947% (2020: 0.984%).

The Manager's regulatory obligations under its Australian Financial Service Licence prescribes a level of cash that is required to be held by the Manager, acting to slow the decline in the Management Fee rate. Notably though, 2021's Management Fee rate is below the limit of 1.025% (including GST and RITC), and while we would love to reduce the rate further, we expect in the near term, it will likely remain near current levels.

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 rightly be considered a success fee as it represents the creation of absolute wealth for Unitholders.

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, reduced the Performance Fee payable to a net amount (as reported above).

With a Management Fee Rebate in place, the Performance Fee becomes the most critical fee for Unitholders to concern themselves with and the means of payment of the Performance Fee – being either cash or units – signals the Manager's commitment to the Trust as well as their conviction in the assets of the Trust. In essence, the degree to which Performance Fees are paid in units rather than cash demonstrates the degree of alignment that is building between the Manager and Unitholders. And alignment is the bedrock to which every financial service should be built from. Accordingly, 102.9% (2020: 93.5%) of the after-tax value of the 2021 Performance Fee has been reinvested in the Trust.

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

Net Income

	<u>2021</u>	<u>2020</u>
	\$	\$
Total Income	196,193,258	85,130,068
Total Expenses	(34,652,229)	(14,807,867)
Net Income	<u>161,541,029</u>	<u>70,322,201</u>

The net income for 2021 led to a 69.65% rise in the Lead Class unit price to \$12.6739.

General Discussion

Growing up in Australia and investing on the ASX, you are certainly exposed to businesses built on commodities, whether that's mining or banking (to take an overly simplified view of the All Ords). And while both types of businesses benefit from having the 'lowest cost of production' – i.e. being able to extract mineral cheaper than the competition or borrowing money at a lower rate than the next bank – a saving grace for the mining company is having some distinction in their 'inventory', being the grade of mineral in a deposit, whereas the 'inventory' for a bank only has one colour.

Capital is the ultimate commodity, with its main purpose being a means of trade (to facilitate current consumption), a unit of account (allowing us to compare the value of dissimilar things) and a store of wealth (enabling future consumption). Accordingly, if capital is not being used for trade (current consumption), then simplistically, it will be used as a store of wealth – and there's no better way to protect the purchasing power of today's capital, than by allocating it to an asset that will grow. In recent years, the market has taken this mindset and run with it, as the securities of companies that may be profitable but aren't growing are priced anemically, but yet unprofitable organisations that are delivering strong growth are priced to levels that seem disconnected from reality.

While this behaviour may seem irrational (i.e. how could a business that's losing money year in and year out be worth more than one that is profitable?), when considering the mechanism by which a business grows and the imperative of the capital that supports that growth, rationality shines through.

Specifically, if a business demonstrates it can acquire customers and then go on to retain and service those customers for long enough to earn an attractive return on the capital that has been invested to acquire and service them, then the interests of the business would be best served by investing as aggressively as its operations can sustain, to win as much market share as possible. If the company is not yet profitable (which is often the case for those businesses growing rapidly – as they're typically early in their lifecycle and either creating a new market, expanding the current addressable market, taking existing market share or some of / all of these), to the outside investor, this will look like a company that continues to produce losses, often at times with those losses growing in value, again, cosmetically suggesting the company is performing worse over time. Though this is completely rational and even desirable (assuming the cost of acquisition and the lifetime value of a customer remain steady at scale – i.e. the business enjoys some competitive moat), as it allows the business to gain the largest market share and in so doing, apply its economics over a greater population of customers.

However there are a few important caveats to this strategy, it only makes sense in so far as the company continues to retain access to capital (either equity, debt or both) while it remains unprofitable and that investors will reward the company with ever higher valuations as it grows and retains customers, increases revenues and maintains or

improves gross and net profit margins – with these two criteria (access to capital and rising valuations) enabling the business to prioritise growth and accept additional capital without it being destructive to the current owners' investment.

Again this is made possible because investors value growth more highly than they do profitability – that is, it's more valuable to capture a larger share of the market while it's still available, than it is to grow slower, albeit through profitability.

So with the business acting rationally to pursue growth at the expense of near-term profits, it's also clear investors are acting rationally by funding this dynamic, as it will result in ownership of a business (albeit somewhat diluted) that has achieved a larger share of the market in a shorter space of time, bringing forward larger cash flows earlier in time – resulting in a more valuable business, now and in the future. And given the point of allocating capital is to firstly preserve the purchasing power of that capital and then to grow it, the most effective way to achieve both objectives is to invest in securities that will grow capital, not necessarily distribute it. Nirvana comes when the business's growth (which remains strong), is not restrained by its profitability – which happens when revenue has been growing faster than the costs to acquire and service those customers that produce the revenue.

Recognising that capital is undifferentiated but growth is unique, it would be irrational to prioritise the production of a commodity at the expense of value. Growth offers access to the deepest pool of value, but to grow over a long span of time, you must be unique. It's clear there is no such thing as growth versus value. Growth is value.

Thank you for your support and confidence.

Luke Trickett

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