BLUE STAMP
COMPANY

21st February 2021

Half Year to 31 December 2020

Performance Measures

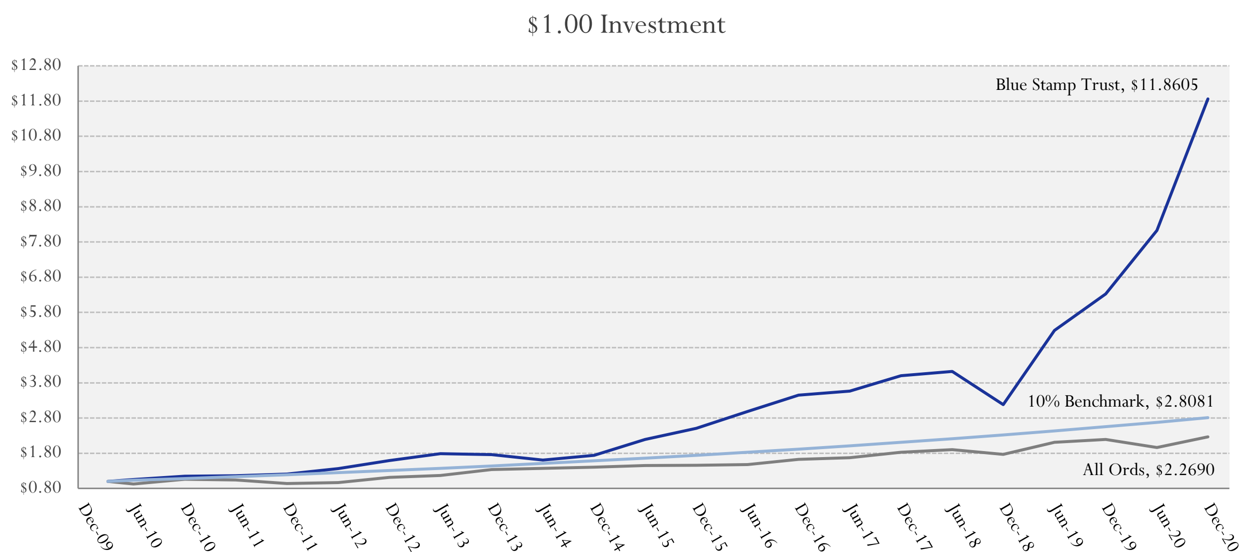
The half year period saw Blue Stamp Trust rise 47.35% (after all fees) to $11.0081/unit for the Lead Class. If you hold units in classes other than the Lead Class, please login to your account to find the relevant pricing information.

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-20	$7.4708	$7.4708	$7.4708	64,331.67
31-Dec-20	$12.3313	$11.0081	$7.8443	74,424.55
Return	**65.06%**	**47.35%**	**5.00%**	**15.69%**

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 2021	1H 2020
	$	$
Investments - Realised	26,196,637	16,106
Investments - Unrealised	107,967,134	27,374,908
Dividends	15,188	-
Interest	2,179	75,266
Other	5	-
Total Income	**134,181,143**	**27,466,279**

Investments

As markets drive ever higher, so too have our core holdings in Afterpay, Megaport and NextDC. Contrary to how it might feel, when prices rise, value falls and risk increases. Given the stock market assigns value based on the *relative* attractiveness of an opportunity – compared to say, long term bond yields – we are being forced to the sidelines more and more frequently, as we aim to identify and invest in opportunities that are *absolutely* attractive, providing expected long-term value that exceeds our annual absolute 10% Benchmark.

Carrying leverage (the Trust's leverage ratio at 30 June 2020 was 12.7%[1]) in an environment of increasing risk is not something we seek out. Accordingly, over the half year period we reduced our holdings in Afterpay and Superloop – but primarily Afterpay – to ensure we were not carrying 'over exposure' in the fund – above the value of our equity. Consequently, at 31 December 2020 all borrowings had been repaid and the Trust held $9.3M in cash. Though a product of all this activity was to produce ~$26M in realised gains during the half.

Almost all of our holdings rose during the half year period, again with Afterpay and Megaport driving the bulk of our gains. No doubt the continued organic growth and expansion of their services into new regions drove their share prices, but undoubtedly the market's willingness to pay ever higher prices for companies offering sustainable growth also contributed.

For Afterpay, their organic growth in Gross Merchant Value during the half year continued at an astonishing clip of ~100% p.a., whilst they also outlined their entry into new regions (including Canada, Portugal, Spain, Italy, France, Singapore and Indonesia). Afterpay's expansion into continental Europe and South-East Asia is being accelerated through relatively modest acquisitions of local credit and BNPL providers in each region. Interestingly, PayPal finally entered the arena during the half, announcing their instalment offering in certain global regions at the same transaction fee rate as their existing non-BNPL (buy now pay later) service (~3% versus Afterpay's ~4%).

[1] Leverage ratio calculated as total borrowings add the following 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 and removing the book value of any privately held investment).

PayPal has a commanding global presence in the payments industry, offering the same 'closed-loop' payment service for online and increasingly offline transactions for any retailer, whether that retailer has a region-specific or global offering. This trend toward payment services offered by single, global brands (rather than region specific) has been underway for some time, so it feels quite natural to now see PayPal or Visa and Mastercard for that matter, accepted as a payment service anywhere you might find yourself (when we used to travel that is). Though it wasn't always that way.

Specifically, here in Australia, the initial means of payment via card (which initially was only a credit card) was through the imaginatively named, Bankcard (being a joint venture of the country's major banks what more could we expect in a name…). When Bankcard was introduced in 1974 it was blending a few things together for greater consumer and merchant convenience. For the consumer, the convenience offered by Bankcard was the ability to pay at the checkout without needing cash, as well as the provision of credit to make the purchase. By accepting Bankcard, the merchant reduced the cash they had to keep on premises, whilst also, and most importantly, eliminate the messy dealings of customer accounts (that is, IOUs), which also played havoc with the merchant's cash flow. Essentially, Bankcard was a real win for both sides of the transaction, and it was only natural for the banks to roll this out as they had the relationship with both sides of the transaction – that is, they could assess and provide credit to the consumer, whilst also being in a position to rollout a network of payment terminals to merchants, and in doing so, acquire the merchant as a business customer of the bank.

Bankcard had tremendous uptake by merchants and consumers in its early years, but as globalisation started to advance and international travel took off (pun intended), the merit of having a payment network that was region specific began to crumble – because in the end, payment services carry the most utility when they are ubiquitous. With Visa and Mastercard's network having no geographical boundaries, whilst also being agnostic to the banking providers in each region, it became clear that the two had cemented themselves as the global rails for card payments – and in 2006 Bankcard was withdrawn from use as a result of declining cardholder numbers. With Visa and Mastercard's global payments network enjoying structural advantages over all other banks in each region, it also became apparent, that the provision of credit should be decoupled from the provision of a payment network – allowing Visa and Mastercard to specialise in building global payment networks and the banks to specialise in maintaining the merchant terminals and providing credit to consumers – to better enable the purchase of goods and services over the payment network.

Obviously, Diners Club and American Express were exceptions to this example, however given they had an overly restrictive merchant network, combined with typically being providers of credit to the wealthier parts of society, they did not have the same presence on the payment and credit industry.

Previously, it just made sense to have consumer credit supplied by local banks rather than single global providers. For example, someone in the US would not have been offered personal credit by Commonwealth Bank of Australia, just like no Australian resident would ever expect to be provided credit by Bank of America. Despite any global ambitions CBA or BofA may have had, geographical expansion into consumer credit markets would very likely have been value-destroying for their shareholders – as confronting incumbent banks and credit providers in new regions would require considerable investment in time and money to pry any marginal customers away from their existing bank.

However, with a change in consumer behaviour currently underway – where consumers are now looking for small, rapidly amortising, 'free' loans that are tied to a discrete purchase, as opposed to the geographically constrained, larger, revolving, interest-bearing loans that are an aggregate of many purchases – the provision of credit is being fused back together with a payment (echoing the early ideals of Bankcard). And the internet is accelerating these trends – of credit and payments being serviced by global organisations and the two merging – because it is driving ever increasing amounts of consumer purchases (aka payments) from in-store to online and

those online retailers are increasingly present in multiple jurisdictions. And wherever the retailers go, the payments companies will be sure to follow.

This change in consumer behaviour is creating an opening for young, legacy-free, geographically unconstrained companies (Afterpay et al.) to hoover up consumers, the world over. Even with all their size and resources, this is an opportunity that was never available to the incumbent banks of each region. And with tectonic shifts occurring in markets as large as payments and financial services, no doubt the banks are left feeling like 'we're not in Kansas anymore', as they watch each domestic consumer credit market – which were large in their own right – fold into an enormous global opportunity and begin to rapidly concentrate into the hands of a small number of 'payments' companies. Accordingly, it only makes sense that Afterpay and others aggressively vie for the dominant global position in the very large consumer credit market.

No doubt all of this is a driving force behind Afterpay's expansion into new regions, as they eye an opportunity in the tens of trillions of dollars – and why the stock market has reacted so favourably to the continued advancement of their BNPL service. While valuations climb higher and the provision of consumer payments and credit matures to a global offering, we are looking as deep into the future as possible, to understand what the best course of action for us to take is. Key to our consideration will be understanding the cards (another intended pun) each of the BNPL players have in their backpocket – that may allow them to sustainably differentiate their service and protect their competitive position.

Indeed, this experience of a service whose competitive position was protected by a geographic moat, echoes that of the traditional media industry, and specifically newspapers – though, enter the internet and their economics were eroded almost overnight. If you're interested, we did speak of this in our 2017 annual letter. Needless to say, the creative destruction wrought by the internet has been profound and shows no sign of abating. It's a wonderful time to be investing (aside from the sky-high valuations…).

For Megaport, the organic growth in their number of services continued at a solid rate of ~40% p.a. over the half year period. Also being in an expansionary mindset, Megaport will be rolling out a new offering to their customers – Megaport Virtual Edge (MVE) in the final quarter of this financial year. By enabling a remote or branch office to have direct connectivity back to a private or public cloud environment, as well as access to the wider Megaport ecosystem of data centres and service providers, MVE is pushing the tentacles of Megaport's network, deeper into the network edge.

By weaving more locations and service providers together in an ecosystem that offers increasing functionality (e.g., MVE), Megaport has been able to differentiate itself as a network fabric that grows more valuable to its customers over time. This value is highlighted in the data below, where Megaport's customers are provisioning more services (i.e., virtual cross connections) over the Megaport fabric and in doing so, weaving Megaport more and more tightly into their network architecture – creating wonderfully sticky customers.

In the 2019 annual letter I spoke about Megaport's deepening ecosystem, referring to the cohort analysis that showed each year's new cohort of customers as beginning their relationship with Megaport by subscribing for more services than the previous year's cohort of new customers (shown by the red box in Diagram 1 below). Compounding this effect was each year's cohort subscribing for more services as they spend longer on the platform (shown by the red arrows in Diagram 1 below).

Diagram 1

Avg. Services per Customer

	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Year 7	20.9						
Year 6	14.8	20.1					
Year 5	11.1	17.8	16.3				
Year 4	8.6	13.1	13.2	12.9			
Year 3	6.7	8.5	10.0	10.2	11.0		
Year 2	5.0	6.3	7.3	7.6	7.8	6.6	
Year 1	2.3	3.3	4.0	4.0	4.0	4.4	4.6

source: Megaport FY20 results

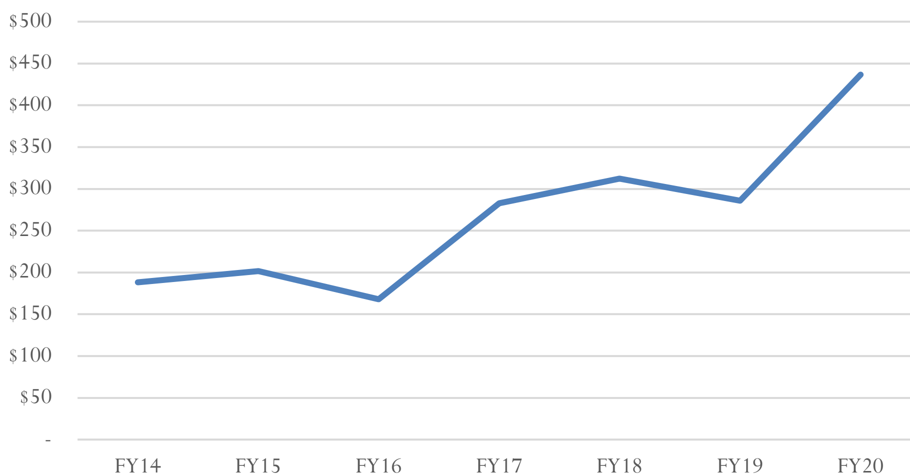
What I didn't mention in 2019 is the increasing amount of revenue Megaport is earning from each of those services, as shown in Diagram 2 below. Impressively, while each year's new cohort of customers is starting their relationship with Megaport subscribing for ever more services, they are also signing up for higher value services (shown by the red box in Diagram 2 and the chart in Diagram 3). Accelerating this further, as Megaport's customers spend longer on the platform, not only do the number of services they subscribe for grow, but most often, so too does the average value of each of those services – compounding Megaport's revenue growth and driving them toward profitability.

Diagram 2

Avg. Monthly Revenue per Service

	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Year 7	$151						
Year 6	$178	$288					
Year 5	$207	$209	$272				
Year 4	$197	$205	$249	$314			
Year 3	$198	$199	$245	$279	$327		
Year 2	$248	$202	$222	$267	$324	$418	
Year 1	$188	$202	$168	$283	$312	$286	$437

Diagram 3



When a company has a differentiated service and a leading position in a growing, global industry and demonstrates an ability to draw in customers in a way that has new customers signing up for greater numbers and higher value services than earlier cohorts – and to have these yearly cohorts go on to subscribe for more services and spend even more on each service over their lifetime with the company – then for the long term shareholder, this company will be very valuable and the shareholder is almost always best served by doing nothing.

No doubt you're getting a new reason to yawn when reading these letters though. Firstly it was simply the banal content, now it's the repetitive banal content, having listened to the same names drive our performance for a number of years now. Active and higher turnover investing provides a form of excitement, the appearance of effort and at a minimum, more variation in content. But all too often the returns of such a strategy wilt in the face of patience. I hear you say, "that's fine, but what are you doing about the next ten years Luke?", to which I would respond with a bit more dross by saying, "working as hard as possible to identify new opportunities that offer attractive, long term absolute value, within the areas we're competent in, whilst also possessing a margin of safety".

The last 6 months has been our busiest to date in researching and otherwise proving up new opportunities for the Trust. There is still little we have to show for this work and ultimately (as always) the research may very well come to naught – because either we don't invest in the opportunity or we did but shouldn't have.

As you may be aware, one of these nascent opportunities is Marmalade – our privately held, B2B payments and cash flow service for businesses. Again, just to recap, through its integration with Xero, Marmalade can be selected as a digital payment service for an invoice that a Supplier sends to their Customer (similar to how PayPal or Stripe can also be selected as a digital payment service for an invoice). Facilitating a payment from the Customer (through either, credit or debit card, direct debit or bank transfer), Marmalade is in a position to provide a new tool for the Supplier to manage their cash flow – by allowing unpaid invoices to be cashed-in early for a one-time fee, with Marmalade accepting all the credit risk of the Supplier's customer. Unlike PayPal or Stripe, whose payment functionality is limited by their inability to handle Customer payments made via the most popular (and archaic) means – bank transfer – Marmalade has built its service to be specifically designed for invoices, aiming to solve the cash flow problem created by them, once and for all. Without diving into all the current and potential ways in which Marmalade may differentiate itself as 'the invoice payments company', the most material is by providing Suppliers a tool to convert their receivables into cash and in doing so, take risk out of their business.

We started building the Marmalade product in late March 2020 and went live, handling our first customer monies on 1 October 2020. With the most basic version of our product built, we remain in a pilot stage as we test the robustness of our payment service. Diagram 4 below provides some high-level data from the first three months (through to 31 December 2020) of this pilot period. As we gain confidence in our payment service, we will seek to grow our Supplier numbers and volume over the coming quarters. Though speaking candidly, it still remains to be seen whether we can cut through all the noise and build a clear and distinct brand, whether our product has been designed and built in a way that fits the B2B market we're serving and most importantly whether we can indeed collect the money from cashed-in invoices – and do all of this in a seamless and scalable manner.

Diagram 4

Suppliers	
Suppliers Onboarded	7
Invoices	
Gross Invoice Volume (GIV) ($)	$868,284.74
Cash-Ins	
Cashed-in Volume ($)	$209,076.65
Received ($)	*$114,094.86*
Receivable ($)	*$94,981.79*
Cashed-in Number (#)	23
Avg. Cashed-In Value ($)	$9,090.29

The opportunity we're pursuing with Marmalade is one that builds on our knowledge in the areas we've previously been investing in and is aligned with our investment objective. By starting and running Marmalade ourselves, there is no other market and no other company that we understand better. This is attractive as it removes the risk of information asymmetry (where management know more about the underlying health and performance of the business than do public market investors), as well as proving up a long-term opportunity, whilst putting little capital at risk.

At 31 December 2020, Marmalade comprised 2.1% of the Trust's net asset value (as measured using Marmalade's book value) and did not contribute any income (being realised gains, unrealised gains or dividend income) for the financial year to date.

Dividends, Interest & Other

Dividend income was marginal during the period and we expect it to remain so for the foreseeable future as our investee companies pursue their growth ambitions, which requires any profitability or free cash flow to be reinvested back into operations.

With a fully invested portfolio, our Interest income was likewise limited during the period and we expect this to remain the case as we look to identify and prove up opportunities that will compound our capital over long spans of time.

At 31 December 2020, <0.1% of the Trust's net asset value was invested in foreign listed companies (1H20: 1.5%). The research we have undertaken during the half has been directed toward proving up domestic opportunities, and if these should continue to develop and justify our capital, then I expect we will remain invested in domestically domiciled companies for the foreseeable future.

Expenses

	1H 2021	1H 2020
	$	$
Investing Expenses		
Brokerage	41,295	160,179
Interest Expense	19,723	75,309
Other Investing Expenses	1,133	1,351
Total Investing Expenses	**62,150**	**236,838**
Management Expenses		
Management Fee	1,416,744	704,899
Performance Fee	23,064,540	3,907,281
Other Fees	-	4
Total Management Expenses	**24,481,285**	**4,612,183**
Total Expenses	**24,543,435**	**4,849,022**

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 charge, which overall, sees the Trust well ahead when compared to the brokerage rates of other providers. However, with a marked reduction in the trading activity during the half, our brokerage expenses had a smaller impact regardless.

At the end of the half year, the Trust had cash holdings of $9.3M and no borrowings. Though as the Trust's leverage ratio[2] includes a provision for all payables (which includes the Performance Fee), at 31 December 2020, the Trust had leverage of 0.63% (1H20: 13.0%).

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 0.50% (2020: 0.49%) of the average net asset value of the Trust over the period. While this is in line with the annual 1% limit, we expect this to begin falling as the Trust has increased in scale.

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.

[2] Leverage ratio calculated as total borrowings add the following 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 and removing the book value of any privately held investment).

Net Income

	1H 2021	1H 2020
	$	$
Total income	134,181,143	27,466,279
Total expenses	(24,543,435)	(4,849,022)
Net Income	**109,637,708**	**22,617,257**

The net income for the half year period drove a 47.35% increase in the Lead Class unit price to $11.0081

General Discussion

These market conditions are making many investors look far better than their capabilities (none more so than yours truly!) and many very capable investors look inferior. Why is this? Well, the central banks around the world set a dangerous precedent during the 2008 global financial crisis of not letting large financial institutions fail. Many of the emergency monetary settings that were put in place in response to the GFC were not exited by the time the next crisis (COVID-19), hit – and COVID had the potential to be a magnitude of order larger than 2008. So now we find ourselves in an environment where real, absolute, GDP growth has been (and will likely be for some time) lacklustre, interest rates are at or near-zero, with major government and central bank stimulus unleashed. And with growth now being such a scarce commodity amongst a system swimming in very cheap (or free) cash, any company offering growth, regardless of there being a path to profitability, will be bid up to prices that 'absolutely', do not make sense. So those investors that have focused their time and attention on identifying companies that have undervalued tangible assets or are generating a stream of income from areas of the economy that are either not growing or in decline, find that their companies just don't get rewarded with the same attention (and valuations) as those companies that demonstrate meaningful growth – regardless of the losses being delivered.

As long as the share price goes up, who cares, right? Well at some point capital markets need to do their thing – they need to be the mechanism by which companies generate returns for investors and investors allocate capital toward those companies that deliver them returns – and by returns I don't mean share price growth – I mean, returns on invested capital (and I'm not talking about EBITDA either!). Don't get me wrong, I'm all for delaying profitability for the sake of delivering a return over a larger footprint of customers, however any investment in the company needs to be made in the context of what those future returns may be. Without this, we're all part of a global form of charity, subsidising the delivery of a company's service to its customers.

When supported by fundamentals, we have always been aggressive with our investing. Though being aggressive is not simply using leverage to build 'over exposure' into the portfolio, but it also captures other factors such as having an intensive research process that dives deep on very specific areas, taking a very long-term horizon to allocating capital and leaning into those opportunities that best satisfy our criteria – to emerge with a concentrated portfolio of companies that we expect to deliver on our investing objective.

As markets have risen though, the manner in which we can be aggressive must shift in order to protect the fund. For example, it is no longer prudent to run leverage with the current opportunities available. However in order to identify opportunities that may keep us growing for the next ten years we must remain on the offence, and we have consequently increased the intensity in our research and undertaken activities that commit us to an exceptionally long-term allocation of capital.

The output of our research remains highly uncertain and while taking a concentrated approach to research has its upside – in terms of a deeper understanding of what we may be investing in – it also carries significant downside, in that we may have spent a large amount of our time exploring a certain niche or one particular company that proves unsuitable to invest in. In this case, we would have little to show for our work, leaving the Trust no more progressed in building its pipeline of investments.

Turning the dial up on our research activities, whilst still concentrating our attention on very specific areas, certainly increases the stakes – particularly if that approach is maintained year in year out. For a manager with a concentrated research and investing philosophy, a marginal hour would have a larger impact on their portfolio if it were directed into a new area rather than building on an already deep understanding in a vertical. Though for the Trust, our approach has always been to build our knowledge in areas we know, so that we can compound our knowledge, which will enable the same for our returns. This is the ante we have upped and how we continue to aggressively invest.

Luke Trickett

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