28th April 2022

To the Unitholders of Blue Stamp Trust,

The Lead Class unit price at the end of March 2022 was $8.1635/unit – representing a fall of 35.59% for the 2022 financial year to date.

If you hold units in classes other than the Lead Class, please login to your account at www.bluestampcompany.com/investors/ to find the relevant pricing information.

In our recent communication, we've spoken at length about some of our holdings and their ability to withstand an inflationary environment – and pleasingly or not so pleasingly, little has changed. Pleasingly, our businesses continue to operate and grow in the manner that attracted us to them in the first place. Not so pleasingly, inflation continues to blaze, with the firefighting by central banks showing little impact so far – other than to cause stock prices to swoon.

With inflation has come (new) expectations for far higher interest rates, which has largely driven the turn in sentiment and fall in the market and our holdings. I appreciate these price movements are not necessarily a comfortable experience to sit through, however more value has emerged in the portfolio in recent months than we have seen for many years – save for a few short weeks in March and April 2020.

To help assuage some of your concerns, I've run through some questions you may be asking yourself.

**Will we recoup the value that we've lost?**

I have no doubt we'll see the full value of our investment return again. The businesses that we're invested in occupy an important part of society and the economy, and that importance is growing as products and processes become more digital. Each one of our holdings also occupies the leading position in their vertical, either globally or within their local market. Accordingly, their revenues and earnings will continue to climb higher, which will in turn drive their value and share price upward and lift the unit price back to where it was, and beyond.

However for this to happen, two things must come together – time and operational performance. That is, the longer we can remain invested in a particular business, the more our investment return will reflect the growth and operations of the business and the less it will be determined by any given market movement or economic shock. Second order implications that arise from this are that the business has a durability in its financial position, a strong competitive position and operates in such a large and growing industry that it has the range to continue growing for many years yet. Gaining a strong understanding of these metrics is the most important aspect to the research that Brock and I conduct on a daily basis.

You might notice that what I've spoken about so far has everything to do with the business and nothing to do with valuation – as it should be. That is, valuation is something we consider only after an assessment of the industry and offering of a given business.

**How are expectations for inflation and interest rates driving value in the portfolio?**

All else being equal, if a stock falls in price then nothing other than value emerges – as we can buy a dollar of future earnings for less than previously.

And as mentioned, the current levels of inflation and interest rate expectations are largely responsible for driving the market (and our holdings) lower. Though for value to emerge, as a first step, the future inflation-adjusted earnings and return on capital of our holdings needs to remain intact throughout these new economic conditions. As we have discussed in previous letters (using Block as an example), while the inflation and interest rate climate may have changed, the expected operational performance of our holdings has not deteriorated alongside their share price – if anything their expected performance has improved! Satisfying the first step for value to emerge.

The second (and final) necessary step for value to come of these share price movements, relates to the way that we value companies. To determine the valuation of any given business, the market applies a 'multiple' over its earnings, with that multiple being a factor of not just idiosyncrasies of the business, but also (and to a significant degree), how 'good' investors feel about the world and the prevailing level of interest rates. Regarding the sentiment of investors, if there are no clouds on the horizon, multiples will be higher. Likewise, if there's plenty to worry about, then reduced multiples are applied over smaller expected earnings (helping to drive the significant swings we see the market undergo). Regarding interest rates, these also follow a simple pattern, whereby the lower the prevailing rate, the higher the multiple and valuation, likewise the higher the interest rate, the lower the multiple and valuation (typically).

Obviously we don't want to be finding ourselves paying high multiples in good markets when earnings are strong (leading to high valuations) and low multiples when sentiment is poor and earnings are weak. A founding tenant of the Trust was ensuring we always had the ability to make investment decisions, independently of market sentiment, interest rates and anything else that causes someone to look at value through a relative lens. Having an absolute return target of 10% p.a. allows us to decouple from this cyclical behaviour and value businesses based on an absolute perspective, on an understanding of what multiple would be fair for the business given its individual prospects, a multiple that assumes neither buoyant nor weak conditions will prevail – meaning that when the outlook for interest rates changes, our parameters to assess value do not change. Satisfying the second step for value to emerge.

**So the share price has fallen while the future prospects of our holdings are either as good as they were previously, or better. And what we would pay for a dollar of future profits has neither increased nor decreased?**

Yep. That's one way for value to emerge. The other way is for future earnings to increase above what was previously expected, without the share price responding. Both dynamics create value, though the latter is a much more comfortable experience than the former.

### If there's more value in the portfolio now, does that mean it was overvalued previously?

As mentioned earlier, there is more value currently available in the Trust than there has been for many years. And while this makes the Trust more attractive today than earlier in the year (when I invested close to 70% of my entire net worth at $12.6007/unit), this is not to say the Trust was overvalued earlier in the year.

On a stock-by-stock basis, as the operations of a business progress and its share price moves, the expected return can swing considerably. If those expected returns fall below our targeted annual average return of 10% and remain there, then it is my obligation to redirect capital away from those holdings and toward new or existing ones that are expected to yield a more satisfactory return. If none can be found, then again, it is my obligation to convert the overvalued position to cash and either wait for more attractive opportunities or return the funds to Unitholders. As some of our positions offered a return that slipped below the 10% benchmark during the first half period, the dynamic of realising some holdings with the intention to redeploy elsewhere was in play and has continued through the March quarter, as we continued to reduce our holding in NextDC and look to reallocate elsewhere.

While the above speaks to a stock-by-stock process, across the portfolio, those positions whose expected return dropped below the 10% benchmark was countered by others that offered a return greater than the benchmark. This is a dynamic that has occurred consistently over the years the Trust has operated and has allowed us to maintain long term holdings whilst achieving attractive returns on our capital. However, when a market falls precipitously, everything falls, preventing the ability for some holdings to support or supplement the returns of others. This has been our experience of late.

Notably though, throughout FY22, the expected future return of the Trust remained above the 10% benchmark (even before the market wilted in the face of inflation), underpinning the allocation of our capital and for me personally, the attractiveness of investing so much of Lib's and my personal wealth at a unit price greater than $12.

### If the market can get the valuation of businesses so wrong in the short term, how does it converge toward accuracy in the long term?

As we've mentioned, over short periods of time, valuation is very much a subjective concept, an exercise that is driven by the fickle swings of the market and its near-term outlook.

But over longer spans of time, the concept (and application) of valuing a business becomes far more objective as the operational performance of a business shines through. Or as Benjamin Graham put it, in the short term, the market is a *voting machine*, in the long term, it is a *weighing machine*.

Why is valuing a business so subjective over short spans of time, and even more so if the business is young and not yet delivering significant, consistent profits? Well it's a direct result of what we spoke about above. Whereby, if the durability and earning power of a business is something that's revealed over long stretches of time (rather than onetime favourable operating environments), then so too will its valuation be. That is, over longer spans of time, a business's valuation will reflect its operational performance and competitive position, rather than the level of forecasted interest rates over the next 6, 12 or 18 month period and the expected multiple of earnings to be applied over that same period.

Looking at any given investment from the first principles of i) what are reasonable expectations for its operational performance and ii) what are we prepared to pay (based off an absolute annual return greater than 10%), we can then act independently of the market and pay appropriate amounts for a dollar of future profitability and best position the Trust to earn an attractive return on capital.

Switching gears and turning our attention to Marmalade, we can see its performance for the March 2022 quarter in the table below.

| | Dec-20 Qtr | Mar-21 Qtr | Jun-21 Qtr | Sep-21 Qtr | Dec-21 Qtr | Mar-22 Qtr |
|---|---|---|---|---|---|---|
| Active Suppliers | 5 | 16 | 22 | 34 | 40 | 68 |
| | | | | | | |
| Total Invoice Value (TIV) | $765,021 | $5,897,616 | $10,823,787 | $16,568,277 | $23,664,147 | $38,063,713 |
| Gross Invoice Value (GIV) | $576,088 | $1,366,978 | $4,752,349 | $10,700,036 | $18,656,401 | $27,664,917 |
| GIV / TIV | 75.3% | 23.2% | 43.9% | 64.6% | 78.8% | 72.7% |
| | | | | | | |
| Gross Cash-in Value (GCV) | $209,077 | $402,140 | $2,793,808 | $4,745,537 | $9,426,258 | $9,340,204 |
| GCV / GIV | 36.3% | 29.4% | 58.8% | 44.4% | 50.5% | 33.8% |
| | | | | | | |
| Invoices Cashed-in (#) | 23 | 54 | 739 | 1,185 | 2,405 | 2,491 |
| Avg. Cash-in Value | $9,090 | $7,447 | $3,781 | $4,005 | $3,919 | $3,750 |

As was previously flagged, our March quarter GCV[1] was slightly lower than December quarter volumes – mainly owing to the seasonality of the New Year trading period, with January typically being a quieter month of activity for SMBs. With GCV being the main driver of Marmalade's revenue, March quarter revenue was largely in line with the December quarter, however our Net Transaction Fee for the March quarter was adversely impacted by the higher provisioning that occurred through the New Year period as receivables aged.

Pleasingly, we added 28 new Suppliers[2] over the period, our highest by a significant margin, as our marketing activities gather some momentum. This contributed to meaningful growth in the amount of TIV[3] and GIV[4] recorded, with more Suppliers using Marmalade across their invoices to more of their customers – further embedding Marmalade into their business operations and most fundamentally, their cash flow. With time, we expect to see this increase in GIV lead to an increase in GCV.

While GIV and GCV are important metrics to track, the GIV / TIV ratio is a leading indicator for the business, showing how engaged Suppliers are with Marmalade. This ratio measures the extent to which Suppliers voluntarily choose to issue their invoices using Marmalade as the payment service. While we aim for a ratio as close to 100% as possible (indicating that every Supplier is issuing every invoice to every customer with Marmalade), what we find is when the number of new Suppliers grows at a faster rate, downward pressure is put on the ratio, as new Suppliers take time to onboard their customers, often choosing to migrate them to the new payment service over time.

1 Gross Cashed-in Value (GCV) is the value of invoices cashed-in by Active Suppliers
2 Active Suppliers - A Supplier who in the last 30 days has issued an invoice with Marmalade as the payment service
3 Total Invoice Value (TIV) is the value of invoices created by Active Suppliers
4 Gross Invoice Value (GIV) is the value of invoices with Marmalade payment details created by Active Suppliers

A second ratio that is informative to measure is GCV / GIV, as this signals the value that Suppliers are receiving from our 'payment-on-demand' service. Interestingly, this ratio changes considerably with the type, size and sophistication of the Supplier – with larger businesses typically cashing-in their invoices more consistently and proactively, whilst smaller Suppliers are more reactionary with managing their cash flow.

The final point worth noting is around *how* we've been acquiring these new Suppliers. At the moment, our acquisition is still largely driven by paid marketing activity, which is not something we want to rely on longer term. Instead our focus is on building out proprietary go-to-market channels that continue to separate Marmalade from everyone and everything else and protect our competitive advantage. Importantly, these channels we're working on do not include brokers or aggregators, which is a means of distribution that existing (commoditised) lenders rely on, but which only acts to reinforce the commoditised nature of their service (for a commission too!).

For Marmalade, we're seeking to develop distribution channels that are built from our brand and leverage our product, with two examples being bookkeepers and payers. Offering a cash flow tool that is built from payments, our product not only helps bookkeepers reconcile the receipt of invoice payments, but it also provides bookkeepers a product to recommend, that is consistent with their trusted advisory position. That is, given Marmalade does not lend money, when someone cashes-in an invoice, risk is removed from the Supplier's business, as compared to a lender whose service increases risk. Accordingly, many bookkeepers see Marmalade as a tool to protect and improve a business and it's our task to understand how we can best activate this network, to promote Marmalade to their client bases.

Regarding the means of growing via payers, this is something that occurs when a Supplier's customer sees that the Supplier is using Marmalade to manage their invoice payments and then signs up for the service themselves – converting from a Payer to a Supplier. We've seen this happen on an ad-hoc, unprompted basis and it's something we're aiming to understand better and gauge if / how we might be able to leverage the opportunity in the future. Given Suppliers, on average, might have ten or more Payers, this distribution channel provides the means to build our brand and presence and acquire new Suppliers without spending any additional marketing dollars. Though we're still a long way from being able to effectively leverage this opportunity, but it is one that should only grow over time, as we acquire more Suppliers.

Backpocket and Marmalade remain the only two unlisted shareholdings in the Trust. At 31 March 2022, Marmalade's book value comprised 5.7% of the Trust's net asset value and 5.2% at cost, Backpocket comprised 1.9% at book value and at cost.

Thank you for the opportunity to invest on your behalf.

Kind regards,

Luke Trickett
Blue Stamp Company Pty Ltd

*Performance Summary (Lead Class units)*

| | Mar-22 Qtr | FYTD | 1 year | 3 years | 5 years | 2-Mar-10* |
|---|---|---|---|---|---|---|
| BST^ | (22.44%) | (35.59%) | (17.19%) | 27.38% | 22.17% | 19.91% |
| Benchmark | 2.50% | 7.50% | 10.00% | 10.00% | 10.00% | 10.00% |
| AOAI | 1.62% | 6.28% | 15.48% | 11.46% | 9.81% | 8.62% |

^Blue Stamp Trust returns are net of all fees and charges and assume the reinvestment of distributions. Annualised returns are shown for periods of 1 year or greater.
*Blue Stamp Trust commenced on 2 March 2010
AOAI – All Ordinaries Accumulation Index
FYTD – Financial Year To Date

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