30th March 2022

Half Year to 31 December 2021

Performance Measures

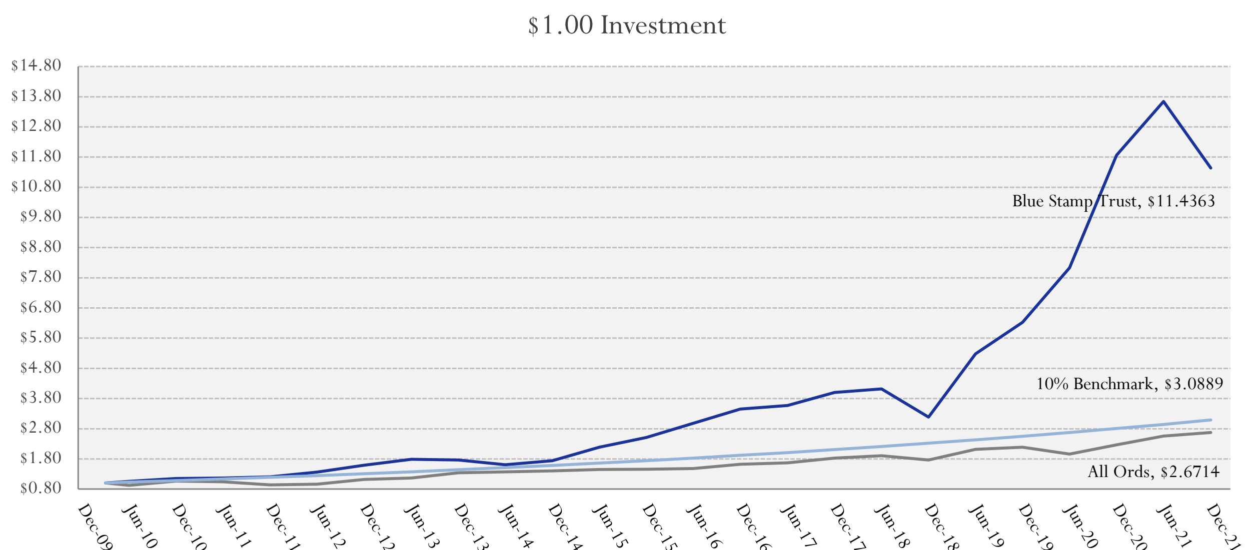
The half year period saw Blue Stamp Trust fall 16.96% to $10.5249/unit for the Lead Class. If you hold units in classes other than the Lead Class, please login to your account to find the relevant pricing information.

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-21	$12.6739	$12.6739	$12.6739	83,786.32
31-Dec-21	$10.5249	$10.5249	$13.3076	87,626.08
Return	**-16.96%**	**-16.96%**	**5.00%**	**4.58%**

Given the fall in unit price over the period, no Performance Fee was provisioned at 31 December 2021.

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

As shown below, the change in value of our long-term holdings drove the fall in unit price over the period.

	1H 2022	1H 2021
	$	$
Investments - Realised	41,980,100	26,196,637
Investments - Unrealised	(106,286,751)	107,967,134
Dividends	53,760	15,188
Interest	5,035	2,179
Other	(2)	5
Total Income	**(64,247,858)**	**134,181,143**

Investments

Markets continued to whiplash during the half year period, as they respond and adjust to a very dynamic economic and geopolitical landscape. There are many reasons for these wild movements, though most relevant to our holdings, has probably been the high and intractable rate of inflation that has caused an 'adjustment' in the outlook that many investors are taking. This adjustment is being reflected in where investors are allocating capital – seeking opportunities that will protect and build on the purchasing power of today's dollar, whilst also moving to those companies that are delivering returns (aka profits) today, rather than some time deep in the future.

Firstly, during the half year period, the global payments company Block (SQ.NYSE) – best known for their point-of-sale (POS) hardware and payment service, Square – made an offer to acquire Afterpay by way of an all-scrip consideration. The transaction was completed in January 2022, with our shares in Afterpay rolling into a holding in Block.

Block is quite possibly the most innovative payment company we have seen and certainly the best at allocating its resources toward developing and monetising products that solve meaningful problems for its customers. Before considering Afterpay's contribution, Block has two powerful 'earning machines', in Square and Cash App. However, describing Block's business as only a function of these subsidiaries overly simplifies its operations as it is also pursuing a number of prospective ventures related to improving the accessibility and adoption of Bitcoin. While we have regard for these opportunities, we ascribe no value to them as they remain too speculative at this point.

More specifically though and in the context of the falls we've seen in markets, I thought it might be helpful to focus in particular on Block's subsidiary Square, discussing some of the characteristics that make it an attractive business to own during this time, and why we are enthusiastic shareholders in the overall Block business.

Firstly, to provide some background on Square, as the story goes, the idea came from a phone call between co-founders Jim McKelvey and Jack Dorsey in early 2009, where Jim described his experience of not being able to sell a piece of glass art because he wasn't able to accept a payment via credit card. Even though most consumers were being issued cards to pay merchants, accepting payments from those cards was still difficult for a large

subset of sellers, requiring long applications to establish a merchant account to receive payments into, purchasing expensive hardware and generally having an overly complex experience.

Essentially, the problem that Square was originally solving (and continues to solve) is one of accessibility of accepting card payments for the many micro-sellers in the US. Or, in Dorsey's words; *we wanted to turn on the other side (of card payments). We want to allow people to very easily and quickly, within 10 seconds, be able to accept cards as payments.*

Thanks to Square a plethora of individual sellers were suddenly able to accept card payments by simply plugging a very low-cost Square Reader into their phone and downloading an app. Selling the Square Reader hardware at or below cost, enabled Square to make its product even more attractive to this cohort of small and micro sized sellers, enabling Square to then earn a recurring revenue stream by charging a fee on each card payment they facilitated (calculated as a percentage of each transaction). This recurring revenue stream more than made up for the sub-zero margins they were earning on the hardware and the cost to acquire and service each seller.

Fast forward to today and the model is pretty much the same, just a whole lot more established and sophisticated – which we'll discuss in more detail below. But before we talk more about Square, it's helpful to understand the climate to which many businesses find themselves operating in, being one of elevated and accelerating levels of inflation. This inflation is particularly problematic in the US, where the overwhelming majority of Square's (and Block's) revenue comes from, as it records the highest levels of inflation since 1982. However, payments businesses have a natural advantage over many other types of companies when it comes to protecting shareholder value against this invisible tax.

To explain further, in 1980 when inflation was roaring through the US economy at +14% (as compared to the 7.9% in Feb-22), Buffett described the pernicious effects of inflation from the perspective of purchasing hamburgers, when he wrote; *Unfortunately, earnings reported in corporate financial statements are no longer the dominant variable that determines whether there are any real earnings for you, the owner. For only gains in purchasing power represent real earnings on investment. If you (a) forego ten hamburgers to purchase an investment; (b) receive dividends which, after tax, buy two hamburgers; and (c) receive, upon sale of your holdings, after-tax proceeds that will buy eight hamburgers, then (d) you have had no real income from your investment, no matter how much it appreciated in dollars. You may feel richer, but you won't eat richer.*

Implied in this example is the consumer's investment appreciating at the same rate as the price of hamburgers – that is, if inflation were zero, the consumer's investment had neither grown nor shrunk, however if inflation was high, then even with a high investment return, the consumer still hadn't experienced an increase in the purchasing power of their dollar (that is, they couldn't buy more hamburgers than when they started) – levying an invisible tax on the investor's returns. For a business to at least maintain (let alone improve) its financial performance and its 'after-inflation return on capital' during times of high inflation, it largely requires two things – again from Buffett, but this time from his 1981 shareholder letter (when inflation was 'only' around 10%...); *Such favored business must have two characteristics: (1) an ability to increase prices rather easily (even when product demand is flat and capacity is not fully utilized) without fear of significant loss of either market share or unit volume, and (2) an ability to accommodate large dollar volume increases in business (often produced more by inflation than by real growth) with only minor additional investment of capital.*

So, much like a runner on a treadmill, the higher the rate of inflation, the faster an investment will need to appreciate just to stand still, let alone prevent it from going backwards.

Before we go any further, let me excuse my use of two Buffett quotes in quick succession… Having named Blue Stamp in recognition of Buffett, I feel we've got the right to cash-in some goodwill and leverage his penmanship a couple of times over – that, or I'm getting lazy.

In the context of Square and Block, with at least three quarters of its revenues being calculated from a percentage of the transaction values being processed, any increase (or decrease) in the price level, will naturally flow straight through to Square's revenue, without Square needing to even 'get out of bed' – let along grow customer (also referred to as seller) numbers, increase its fixed cost base or otherwise invest more capital into the business – conclusively satisfying the two criteria of such a 'favored business' that can effortlessly adjust to the inflationary environment in a manner that protects shareholders' real wealth.

Given the high rate of adoption of Square's products amongst micro-sellers in the food service vertical, I have no doubt Buffett's hypothetical burger seller in 1980 was using Square to accept payments… so for Square, it's inconsequential how rapidly the price of burgers spirals upwards – they will continue to process the payment with the same infrastructure and fixed costs and continue to charge a fixed percentage of the transaction value. However, what does become worthy of consideration, is when the consumer only purchases six burgers instead of ten because their wage hasn't kept pace with inflation, and they can no longer afford the same amount. With consumer confidence and consumption dropping in line with affordability, then no doubt Square would feel the impact of reduced trading volume.

Something for us to also consider is that with a rate of inflation greater than zero, any company that is not profitable will be slowly eroding shareholder wealth. However, this 'erosion' can be more than made up for in the underlying *unit economics* (the incremental return on capital from selling one additional unit of product) the company is achieving. In fact, the company's unit economics may actually be the cause for the lack of profitability, as the company brings forward investment in resources in order to gain share in a winner-takes-all market. While this is completely rational behaviour, the greater the rate of inflation in the interim (while the company is investing in itself to drive the adoption of its product wider), the faster it will be going backwards – as shareholders must continue to shovel more equity into the furnace to keep the engine not just going but maintaining the same ability to acquire a unit of resource to grow the business. Again, for the most part, the cumulative cash flows of a business investing for growth will turn from negative to strongly positive and make up for the interim period of negative real rates of return, provided the unit economics do not deteriorate. However if the rate of inflation begins to spiral and the business's revenues do not adjust freely with the rate of inflation, then those unit economics will quickly unravel, again confining shareholders to continued poverty. Why is this relevant to Square (and Block)? Well Square has an industry leading product with attractive unit economics, in a very large market that is driving them to invest to gain market share, at the expense of near-term profitability. So in most years, with largely stable prices, the real wealth (that is, adjusted for the impact of inflation) of Square shareholders has only modestly being going backwards, which was being more than made up for in the expansion of its service across more customers, whilst its unit economics held stable. Presuming consumer confidence and consumption volumes return to levels that were prevailing before this period of high inflation, and with revenues that naturally float upwards with the price-level, Square will be one of the few companies that can invest aggressively during this period and still retain its target real return on capital both in the near-term and over longer spans of time. We can see the performance of Square's unit economics playing out in the data below – and in summary, we like what we see.

Though before we get into the data, we need to clarify some industry jargon around key metrics that are used to assess the unit economics of a business, being:

i) the cost to acquire a customer (CAC);
ii) the churn of a customer (meaning how quickly a customer disengages or otherwise stops using the product); and
iii) the lifetime value of a customer (LTV).

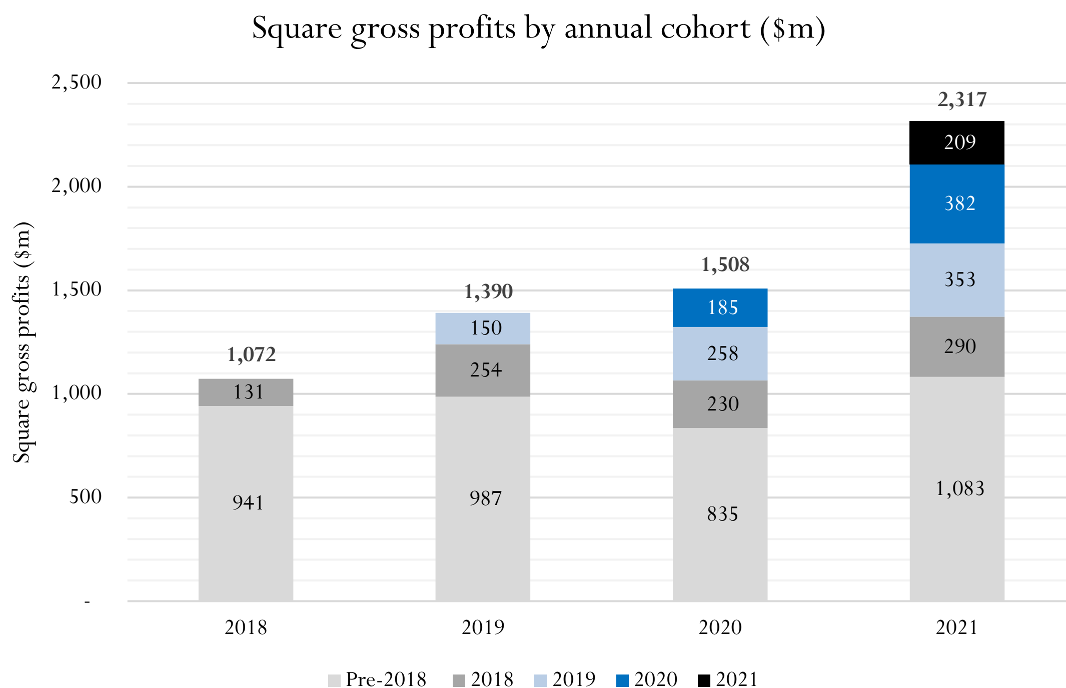
Simplistically speaking, the lower the churn, the longer an average customer's lifetime will be. For those businesses that rely on repeat usage from their customers, these are important metrics to understand, as they determine how much cash the company will need to fund its growth, when and to what extent the business might

expect to reach profitability and ultimately (and most importantly) the expected return on the capital that has been invested to build its product and then acquire and service its customers. Generally, the longer it takes to recoup the cost to acquire a customer, the more cash the company will spend before it will be able to begin to generate a return from that customer's patronage – this dynamic also limits how fast and for how long the business can grow (a theoretical and mathematical quirk shows that if a business's growth rate exceeds the rate at which they earn profits from their customers relative to the cost to acquire those customers, then that business's cash flow will be on a one-way path into a never ending well of losses). In addition to recouping CAC, the LTV of the customer is vitally important, whereby the shorter the customer spends using and paying for the product, the less value that customer offers, consequently producing a lower return on the company's investment.

Businesses that operate in large markets whilst also having a sustainable differentiation in their product that organically draws in new customers and retains them for long periods of time, become very large, very powerful earning machines. Measuring how a business's unit economics perform over time and how these unit economics may change for cohorts of customers acquired at different points in time, tells us a lot about the potential longer term earning power of the business.

Like Block's Cash App subsidiary, Square also benefits from a positive gross profit retention dynamic (shown below in Diagram 1), whereby the gross profits earned from a cohort of customers acquired during a specific period, grows faster than the revenue lost from customers in the same cohort that churned away from the product. For example, the 2019 cohort produced $150m of gross profits in their first year, with that same cohort of customers producing $258m of gross profits in 2020 and $353m in 2021 – even after including the attrition of customers leaving.

Diagram 1



Source: Q4-2021 Shareholder letter

Even though COVID had a material impact on 2020 transaction volumes and gross profits, if we look at two-year and three-year average growth rates of gross profits by cohort some interesting trends are revealed. For instance, sellers who onboarded and processed their first transaction with Square in 2018 grew gross profits at a three-year compound annual growth rate (CAGR) of ~30% to $290m in 2021 (net of churn in the cohort). Similarly, the 2019 cohort grew gross profits at a two-year CAGR of ~53% to around $353m in 2021.

The ability for a company to deliver positive gross profit retention from their customer base is achieved by a small number of businesses, typically those who have an industry leading product that benefits from repeat usage patterns, enabling the company to attract and retain a highly engaged customer base that expands their relationship with the company as they consume and pay for more products sold by the company. In the case of Square, the major factors that impact their gross profit retention figures are:

1. Transaction growth of retained customers (Square grows as their customers grow);
2. Increase in engagement of retained customers (Square sells more products over time); and
3. Reduced churn in customers that started in the cohort (Fewer customers leave Square over time).

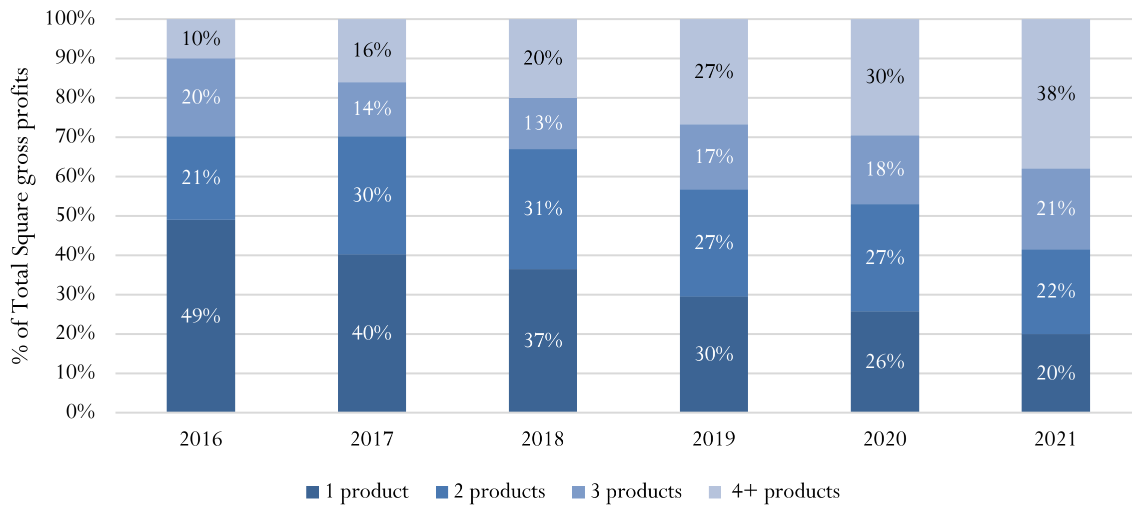
While we're given limited specific operational data on Square, for the first factor mentioned above, the connection between the growth in a Square seller's revenues with growth in transactions processed and gross profit earned is clear. We can also infer the second factor (existing customers taking on more Square products) has likely contributed to growing gross profits per cohort. For instance, Dorsey mentioned in 2019 that 70% of Square Online sellers have used Square before expanding online, whilst also highlighting that Square generally sees an increase in volumes from sellers who either started offline and moved online and vice versa for sellers starting online and moving offline[1]. Compounding this, as sellers get more comfortable with the Square ecosystem of products and discover more functionality, they often start experimenting with additional products, such as using Square Loans to fund the purchase of inventory or they look to streamline the payment of wages through Square Payroll etc. We expect the expansion of Square's product capability to be an important factor in continuing to grow gross profits per seller cohort.

Last but not least, increasing retention rates of seller cohorts (or alternatively put, reducing churn) has a leveraged impact on the business as it means more sellers stick with Square over longer periods of time, enhancing the positive gross profit dynamics Square enjoys when the transaction volume of their customers grows and when those customers take on more Square products. As Square moves deeper into key verticals such as restaurants and continues to attract larger sellers with more complicated requirements, we see an opportunity for retention rates to increase and this positive gross profit retention dynamic to continue to strengthen.

In a positive signal toward customer engagement and the unit economics that flow, we can see in Diagram 2 that as Square's product offering has grown, so too has the contribution of gross profits from sellers using more than one product. For example, gross profits from sellers using more than four monetizable Square products (excluding hardware) has increased from 10% of total gross profits in 2016 to over 38% of total gross profits in 2021, while the gross profit contribution from sellers using only one Square product has declined from 49% in 2016 to 20% of total Square gross profits in 2021.

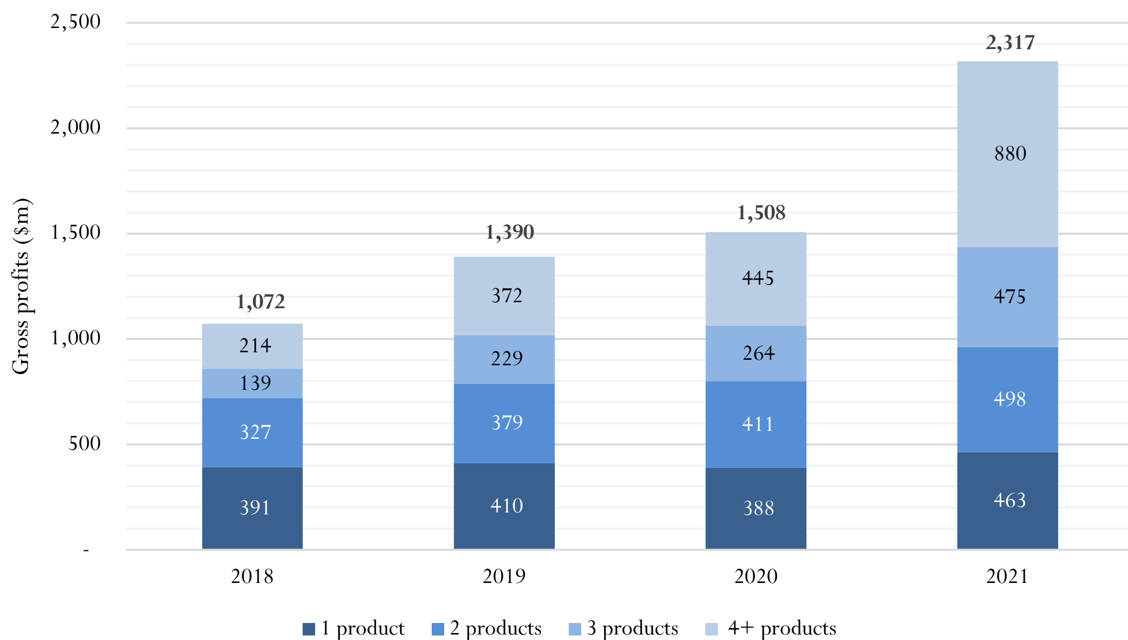
[1] Comment by Jack Dorsey in the Q1'2019 earnings call

Diagram 2



While the percentages in Diagram 2 indicate Square is doing well to gain relevance amongst sellers with more complex needs (which are generally larger sellers), we need to consider this mix-shift in light of the absolute gross profit contributions of each cohort, which is shown in Diagram 3.

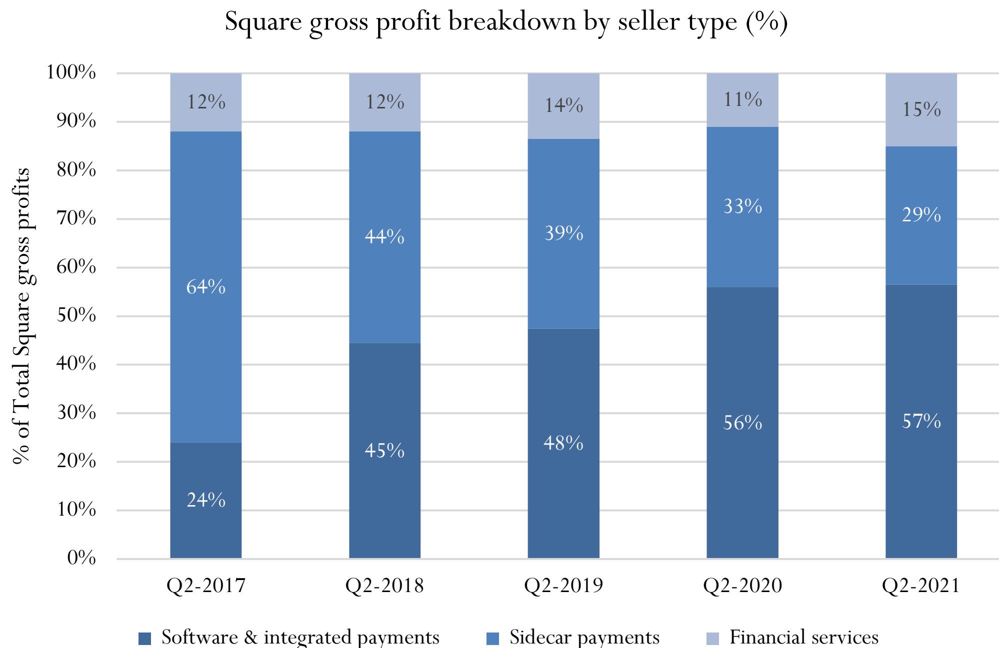
Diagram 3



Gross profits from sellers utilizing three or more Square products (excluding hardware) has grown quite rapidly over the last three years, at an average annual rate of 56% to around $1.36 billion in 2021. On the other hand, gross profits from sellers using one or two Square products (excluding hardware) grew at ~10% p.a. over the last three years to around $961 million in 2021. Most importantly, the percentage increase in gross profits from sellers using more products has not come from a reduction in gross profits from sellers using less products.

Diagram 4 below, begins to dig into the nature of some of these additional products that sellers are purchasing from Square. Pleasingly, the portion of Square's gross profits coming from *sidecar payments* (that is, gross profits from sellers who only use Square payments without using any other software or services) has declined over time as sellers have taken on more Square products outside of payment services, that help them run their business and has enabled Square to generate additional revenue from these sellers, in the form of subscription and service fees and financial service income.

Diagram 4



Gross profits from sellers using and paying for software in addition to payments, has increased from only 24% of total gross profits in Q2'2017 to well over half of all gross profits in Q2'2021. This is supported by Diagram 2, where gross profits from sellers using three or more products has increased from 30% in 2017 to almost 60% in 2021.

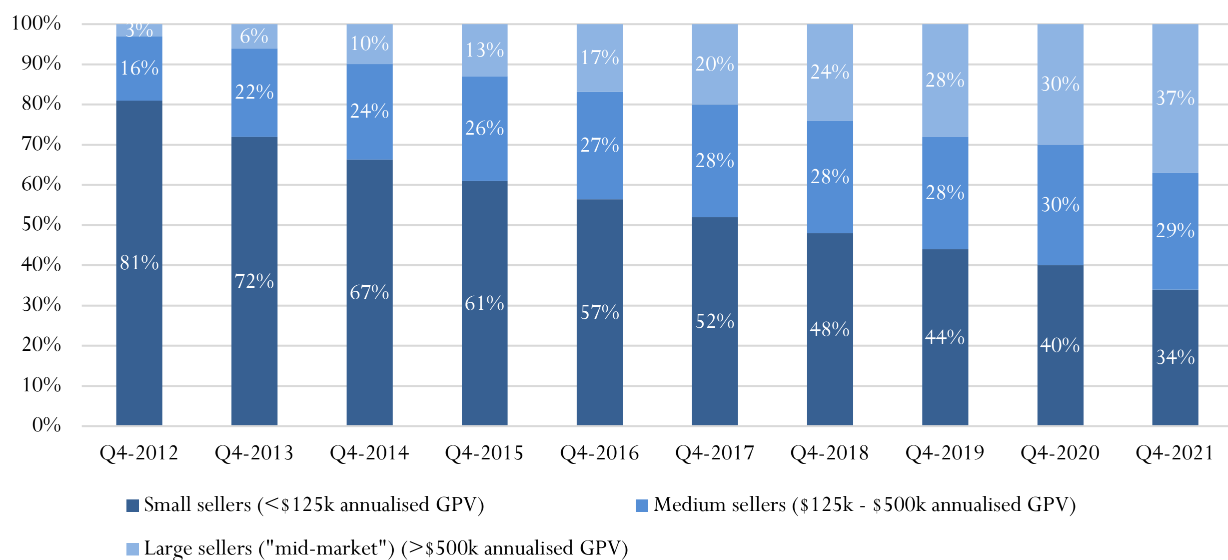
This data makes us increasingly confident that the recent development by Apple to turn the iPhone into a portable POS terminal will have a minor impact on Square's overall gross profits as the average Square customer is using the Square ecosystem for many more jobs than simply accepting a payment. Whilst Apple is focused on developing the most intuitive hardware and software for *individuals* to use in their everyday lives, Square is laser-focused on providing *sellers* with valuable tools to run and grow their business. As a side note, this echoes what has occurred since Apple's public release of Apple Cash (peer-to-peer money transfer capability that lives within iMessage) in 2018. Whilst the iPhone is held by a large portion of Cash App's customer base, Cash App has remained the top financial app for many of its customers because it solves many of their problems with extremely simple and accessible tools.

To be clear, sellers taking on more Square products is a great signal for us, as it not only allows Square to generate more revenue from each seller, but it also means Square can serve larger sellers who produce higher revenues and gross profits for Square, whilst at the same time, embedding Square deeper into the seller's business. The net result of all of these factors is to increase the lifetime of a seller using Square's products, which drives a higher LTV and most fundamentally, provides Square with a consistent (or greater) return on the capital invested as it expands its addressable market. This is consistent with anecdotal comments made by Block CFO, Amrita Ahuja,

who has pointed to these dynamics enabling the business to target longer payback periods to recoup the cost to acquire a seller – from a previous target of three to four quarters, to now around six – again, whilst still maintaining a consistent return on capital.

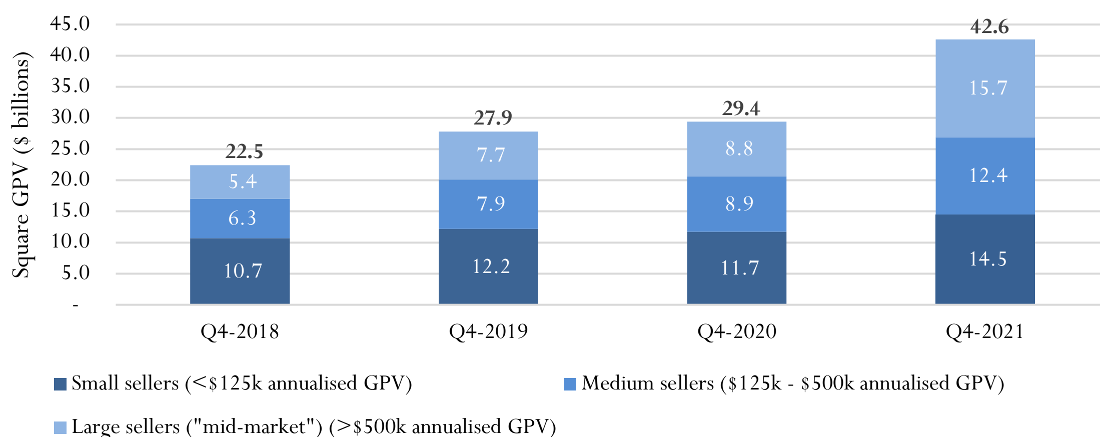
Building on this train of thought further, Square's growing ecosystem of products has allowed it to expand the types and sizes of sellers it can serve – maturing beyond the focus on micro-sellers in its early days. For example, developer platforms such as Build with Square as well as more sophisticated and vertical specific POS products like Square for Retail and Square for Restaurants has helped grow its product suite and capability to serve the more complex needs of larger sellers. In doing so, Square has been able to grow its addressable market, with gross payment value (GPV) contribution from larger sellers (that is, sellers with annual GPV >$125,000) increasing from 19% of total seller GPV in Q4'2012 to 66% in Q4'2021, shown in Diagram 5 below.

Diagram 5



Pleasingly though, Square's growing contributions from larger sellers has not come at the expense of GPV growth from small sellers – shown in Diagram 6 below.

Diagram 6

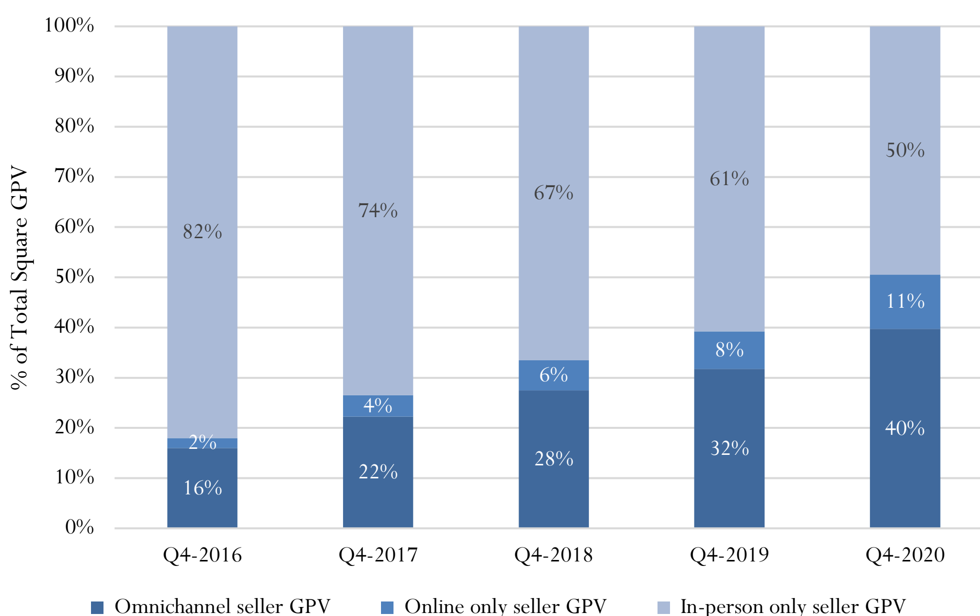


Whilst total fourth quarter GPV has grown at a CAGR of 24% over the last 3 years, contributions from larger sellers has been growing at an even faster rate. Even though this category does benefit from being uncapped, Square has grown its GPV from the largest sellers with annualised GPV greater than $500,000 at a three-year average annual rate of 43% to $15.7 billion. Meanwhile, GPV from small sellers has grown at a three-year average annual rate of only 11%. As mentioned earlier, a major source of future growth for Square will be continuing to move up-market into larger and enterprise sellers.

This dynamic of increasing gross profits from sellers utilising more Square products at the same time as increasing GPV contributions from larger sellers is not purely coincidental. In fact, Square has explicitly pointed out that growing up-market has led to attracting larger sellers with more complex needs, and thus more potential problems to be solved with Square products; *Typically, we've seen our mid-market sellers use more products on average and develop deeper relationships with Square. Sellers using 4 or more products generated more than 10x the gross profit on average in 2021, compared to sellers only using 1 of Square's products (excluding hardware devices and only includes monetized products)*[2].

In addition to growing up the seller-curve, Square is also demonstrating an ability to expand into new and complimentary markets – such as moving from previously an in-person only payment service to one which can also be used online. Having an omni-channel product and presence not only provides the company access to a larger and more sophisticated customer base that sells across multiple channels, but it also provides Square the ability to increase its monetization of its existing seller base, as more consumer spending shifts online. As shown in Diagram 7 below, Square's GPV from omni-channel sellers has increased rapidly over the last five years.

Diagram 7



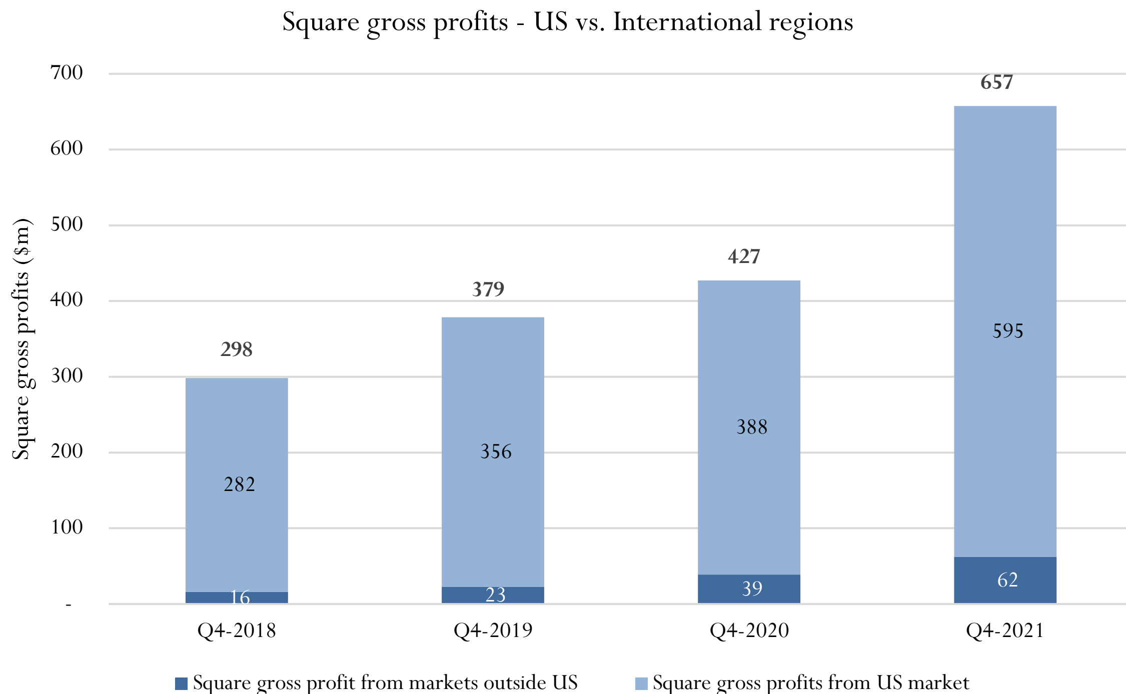
Whilst the above graph is a year out of date (due to limitations of data disclosed by Block), there is a discernible trend of rapid growth in omni-channel commerce – a trend which again is consistent with the increasing average size and complexity of Square's seller base, whilst also providing another example of how Square is able to continually improve its monetisation of each seller, as sellers utilise more of Square's growing ecosystem of products.

Finally, expanding Square's service to international markets, as well as levelling up the breadth and depth of Square's products offered to sellers outside the US market, is a key focus for the company and its future growth.

[2] Block Q4'2021 shareholder letter

Given the challenges faced by sellers in many developed economies is universal and the market size outside the US is much larger than the US, the opportunity for Square in the years ahead is significant. Diagram 8 shows the group's progress in expanding their presence and earnings from non-US markets.

Diagram 8



In Q4'21, 9% of the Square ecosystem's gross profits came from international regions, up from 4% in Q4'17 – despite the US market's gross profit more than doubling over the same period. With Square still relatively early in its international expansion, it's clear that a large source of future growth for Square will come from international regions.

What's clear from all these metrics is that Square is becoming an integrated component to the operations of an increasingly diverse profile of sellers', bringing more value to sellers and driving more value into Square's unit economics – with these unit economics being applied over a larger market opportunity – traversing online and in-store and now increasingly, in regions beyond the US. A powerful earning machine is building for Block shareholders, and this is before we've spoken of Cash App, another engine of growth, founded within the wider Block business from a culture of decentralised decision making and entrepreneurialism. This is why we think Block is the most long-term minded, innovative and disciplined payments company in the world, and why we want our capital with them, especially in these current times. And all of this started from a tiny Square Reader that plugged into the headphone jack of a mobile phone.

While we remain enthusiastic shareholders of Block, we did make the decision to meaningfully reduce our holding in Afterpay (at the time) during the half year period – generating the realised profit shown above. This enabled the Trust to remain in a net cash position, ensuring funds were available for suitable investment opportunities as they may arise.

By way of an operating update for Marmalade, Diagram 9 shows strong growth achieved in the December quarter.

Diagram 9

	Dec-20 Qtr	Mar-21 Qtr	Jun-21 Qtr	Sep-21 Qtr	Dec-21 Qtr
Active Suppliers*	5	16	22	34	40
Gross Cash-in Value (GCV)	$209,077	$402,140	$2,793,808	$4,745,537	$9,426,258
Invoices Cashed-in (#)	23	54	739	1,187	2,416
Avg. Cash-in Value	$9,090	$7,447	$3,781	$3,998	$3,902

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

No doubt though, December quarter's growth was assisted by seasonality, as invoices were cashed-in and payments pulled forward in the month of December to manage the quieter holiday period that lay ahead. Consequently, we've seen a slower start to 2022 and an ageing in our receivables as payment times lengthened over the New Year period – a dynamic that will see our bad debt charges rise in the period ahead.

Also of note during the Dec-21 quarter, Marmalade recorded the significant milestone of annualised revenues exceeding $1m, for the first time. However, having economics that resemble those of a lender, the most important factor is not recording revenue growth, but seeing the capital return safely back to the Group – which is a function of the Group's risk and data capabilities informing appropriate underwriting decisions to effectively manage losses.

As Marmalade looks out to the period ahead, we can see that growth will continue to be constrained as we build the necessary risk technology and payment reconciliation software to manage Supplier acquisition and payment volume at scale and in a manner that allows us to monetise the opportunity. While we still have significant work ahead to validate the opportunity, we have likewise seen some encouraging signs that an invoice payment service is valuable to Suppliers and can be delivered in a way that *integrates* Marmalade into each of our Supplier's business – rather than the modular relationship that many financial service providers find themselves in.

Almost by definition, being an integrated service provider means we bring newfound value to Suppliers' operations, in a manner whereby that value cannot be retained or replicated without Marmalade's service. Strengthening this integration further is having a Supplier's customer payments migrate onto Marmalade's 'invoice payment rail' – meaning, each time the Supplier receives a payment, the cash flows from their customer to the Supplier, through Marmalade. With this invoice payment rail in place, we can provide free remittance and reconciliation services, as well as empower Suppliers with the ability to have invoices paid on-demand.

An integrated service is a necessary criterion for a business to be able to generate 'durable value' – which is value that's protected from competitive forces taking market share, eroding pricing power or both. A clear example of this dynamic is the integration Apple has engineered between the iPhone, iOS and its users, allowing the company to control the entire user experience and in doing so, earn super-profits[3] on manufacturing (e.g. retailing hardware) and all associated services that use their software (e.g. in-app purchases), whilst also being protected from competition eating away at the value they've built (e.g. if a consumer wants to have an iPhone, there's only one place they can get it from, likewise if app developers want to reach the largest audience they

[3] We loosely define 'super profits' as the profits produced by a company that i) achieves a high return on capital ii) is protected by a wide economic moat iii) operates in a large market opportunity and iv) delivers earnings (on an absolute and per share basis) that climb ever higher.

must build their app for iOS – all the while Apple reaps super profits from the stakeholders that rely on this integrated value chain).

The opposite of being integrated is being a modular service, which is an affliction that the overwhelming majority of businesses find themselves in. The customer of a modular service provider will be able to swap out the modular provider with any other alternative without experiencing any significant impact on their operations and no reduction in the performance and capability of their business. Almost any lender (to businesses or consumers) is an example of a modular service provider – which is why we see banks needing to fight every single day for their next customer (or to retain their existing customers), by offering the lowest possible interest rate on their loans or the highest possible deposit rate on their bank accounts. Interestingly, when online lenders entered the market, providing SMBs with rapid access to lines of credit (albeit at high interest rates), they saw significant initial success as many SMBs that were otherwise denied approval by the banks or were turned off by their long processing times, found an attractive alternative. Though over time, the modular nature of these online lenders has come to bear, as the initial success of a small number, drove many more to enter the market, to the point where there is as much, if not more competition at the smaller end of the business lending market as there is at the larger end of town. The outcome of this would first present itself in the unit economics of these businesses, where they would see a gradual increase in the cost to acquire a customer, a shortening in the time a customer spends using the service and most painfully, they would find it harder to keep their prices where they are, let alone increase them. All of this causes the business to have to invest more capital to achieve the same or inferior amounts of profit, putting a hard ceiling on how valuable the business will ever be.

Why am I saying all of this? Well, we think very hard about the long-term pathway for Marmalade (and all our holdings), ensuring that any value we do create will not just continue to be in place for our children and grandchildren, but will continue to be built on as Marmalade looks to generate an attractive return on the capital invested, year in and year out, compounding its absolute and per share earnings higher, generating real wealth for shareholders. But to achieve this, Marmalade must first ensure it remains an important and integrated component to each of our Suppliers' operations.

At 31 December 2021, Marmalade's book value comprised 4.4% of the Trust's net asset value and 4.0% at cost. Backpocket comprised 0.9% at book value and at cost. The Trust did not purchase or sell any shares in Marmalade or Backpocket during the half year period and neither company contributed any income (being realised gains, unrealised gains or dividend income) for the financial year to date. Backpocket and Marmalade remain the only two unlisted holdings in the Trust.

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 2021, <0.1% of the Trust's net asset value was invested in foreign listed companies (1H21: <0.1%). I expect we will remain invested in domestically domiciled companies for the foreseeable future.

Expenses

	1H 2022	1H 2021
	$	$
Investing Expenses		
Brokerage	45,087	41,295
Interest Expense	44,756	19,723
Other Investing Expenses	1,225	1,133
Total Investing Expenses	**91,069**	**62,150**
Management Expenses		
Management Fee	1,804,420	1,416,744
Performance Fee	-	23,064,540
Total Management Expenses	**1,804,420**	**24,481,285**
Total Expenses	**1,895,488**	**24,543,435**

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. The brokerage incurred over the half year period was driven by our decision to reduce our holding in Afterpay.

The Trust had an average leverage ratio[4] of ~3% over the half year period, which drove the interest expense incurred. However, at 31 December 2021 the Trust had a net cash position of $14.7m or 4.8% of the Trust's net asset value.

Other Investing Expenses comprise market access fees.

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% (2021: 0.50%) of the average net asset value of the Trust over the period. While this rate is in line with the annual 1% limit, we expect it to fall as the value of the Trust increases. Any Management Fees paid will be carried forward and rebated against any future Performance Fees earned.

Given the fall in value of the Trust over the period, no provision for a Performance Fee has been made.

[4] 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 2022	1H 2021
	$	$
Total income	(64,247,858)	134,181,143
Total expenses	1,895,488	24,543,435
Net Income / (Loss)	**(66,143,346)**	**109,637,708**

The net loss for the half year period drove a 16.96% decrease in the Lead Class unit price to $10.5249

General Discussion

At the moment, we aren't accepting any additional capital into the Trust (from new or existing investors), due to some potential inaccuracies in the current unit price that is being created by Marmalade (and to a lesser extent, Backpocket), which we feel could be undervalued.

To explain further, because Marmalade is a privately held business, its shares are not actively traded on a public stock exchange (like the ASX), so the value of the Trust's holding in Marmalade is being recorded at a price which may not reflect the value Marmalade would receive if it were publicly listed. This situation, where an investment is recorded by the Trust at a value that is different to what it would receive in the market, creates inequality between Unitholders when capital is either invested into or withdrawn from the Trust.

We are working on two aspects to mitigate this going forward, which include:

1. Restructuring the units of the Trust
2. Conducting periodic market valuations of the unlisted investments

Restructuring the units of the Trust involves splitting the current units (which provide an ownership interest over all assets of the Trust) into three new classes:

- Liquid Class
- Illiquid Class – Marmalade
- Illiquid Class – Pixel Payments (Backpocket)

Splitting the current units into these three classes achieves the outcome where each of the new classes would provide an ownership interest over a discrete subset of assets, in the same proportional ownership as occurs today. To be clear, this proposal would not cause any change in the ownership stake you currently have in any of the Trust's assets or their value. For example, the ownership interest in Marmalade that a single unit in the Trust currently provides, would remain the same despite being in a new and separate class. With the proposed changes in place, as capital enters or exits the Trust, it would only be invested into or redeemed from the illiquid classes if the underlying asset (that is, Marmalade or Pixel Payments) was being recorded at market value. If the investment in the illiquid class were not considered to be at market value, the application or redemption would be processed when a market valuation is next struck. There would be no change to how capital is invested into or redeemed from the Liquid Class, which includes all the Trust's holdings in publicly listed investments. At 31 December 2021, 94.7% of the Trust's net asset value was in liquid assets.

As for the practicalities of this restructure, we are first making a submission to the ATO for a private ruling, seeking to ensure that the proposed changes will not trigger any tax consequences for Unitholders. Provided we receive a favourable outcome from the ATO (which we expect to receive), we will then seek Unitholder approval to make the change. As part of seeking Unitholder approval we will provide a clear outline of all the

changes being proposed, the reasons for such and the implications for your Unitholding in the Trust. We expect to have received a response from the ATO between May and August. Depending on any requests from the ATO for additional information, the timeline may extend, but we're hopeful this will not be the case.

Regarding the second component to help mitigate any inaccuracies in the unit price, each private company will seek to raise capital from professional early-stage investors in order to strike a market valuation. While the frequency of these capital raises will be determined by each of the individual holdings, when we have a firm understanding of the outcome, it will be communicated to Unitholders in a timely manner.

Finally, with the volume of work having recently increased, the cadence and format of Unitholder communication will shift to quarterly updates that are shorter in nature and focused on the key events that have occurred over the previous period that are relevant to the Trust. Accordingly, I will no longer draft these semi-annual letters that provide a broader, qualitative assessment of our investing decisions and the Trust's performance. This was a difficult decision to make as I enjoy drafting these updates – so you can be sure, if my time commitments reduce, they'll begin to appear again. As always, if you have any questions or concerns about anything I've discussed, please do not hesitate to contact me.

Luke Trickett

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