23rd April 2023

To the Unitholders of Blue Stamp Trust,

The Lead Class unit price at the end of March 2023 was $3.6422/unit – representing a loss of -1.29% for the 2023 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.

Firstly, apologies for the late unit pricing and quarterly letter this month. While it's nice to enjoy some public holidays, the trade-off is that things move slower.

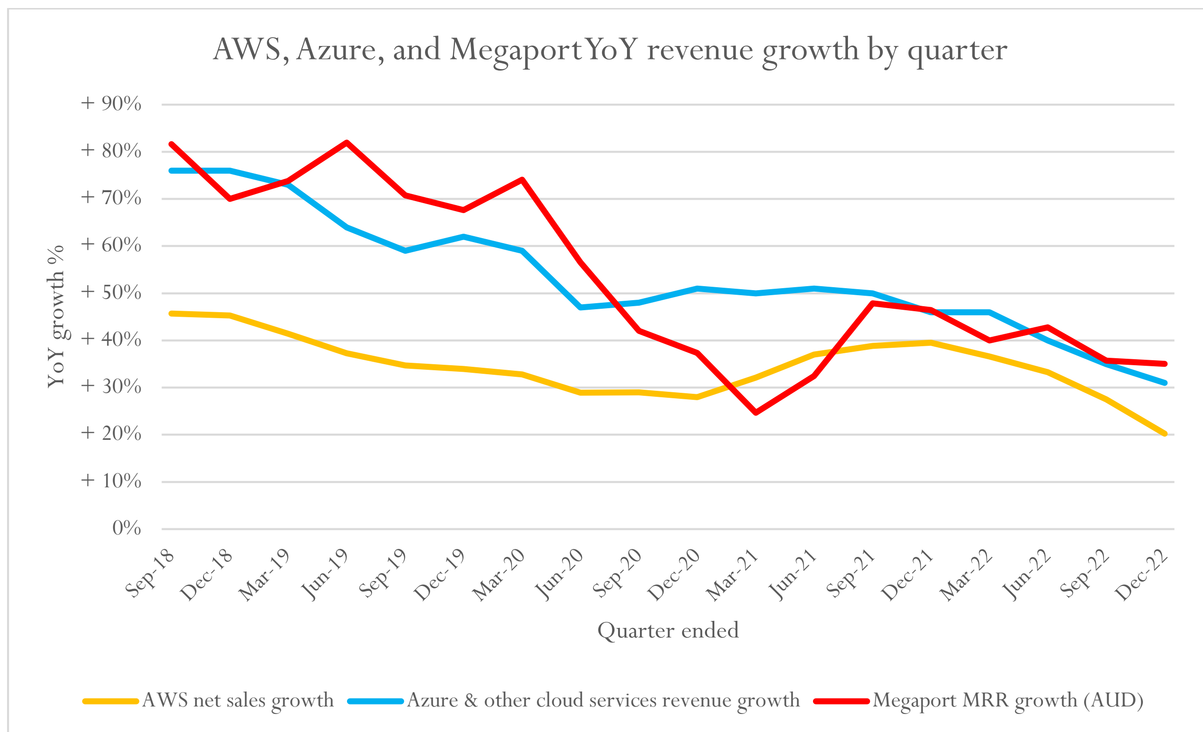
The March quarter saw a retracing of the gains we had made over the year-to-date, with the biggest contributor to this negative performance coming from our holding in Megaport.

Similar to a number of other technology-led businesses, the COVID-19 pandemic was a boon for Megaport which saw a significant pull-forward in demand for their services due to the impacts that the lockdowns had on internet traffic volumes. Many large enterprises with mission critical and time sensitive applications had to rapidly scale and adjust their network footprints to meet the new demands of their end users. However, as the lockdown tailwind turned into a headwind (with some people returning back to the office), and capital became scarce and expensive in 2022, new customers have been harder to come by. With many large enterprises heavily scrutinising their cost bases over the course of FY23 and holding off on new IT spending commitments, conversion rates in Megaport's sales pipeline have dropped significantly.

As a result, in the Dec-22 quarter Megaport added the smallest number of customers in over six years (since the Jun-16 quarter)! Additionally, some of Megaport's more nascent and fastest growing services, the Megaport Cloud Router (MCR) and the Megaport Virtual Edge (MVE), for the first time, contracted in their number of services, causing a wave of concern amongst investors that Megaport is 'ex-growth'. The cloud giants, Amazon (AWS) and Microsoft (Azure), have also felt the impacts of the 'global cost review' with their own rate of growth moderating on prior periods.

Unfortunately, these external headwinds have also coincided with internal headwinds including low productivity and high turnover in Megaport's sales team. For context, Megaport's 'Scale Up, Scale Out' initiative aims for the nirvana of having someone else's sales rep (and someone else's expense) selling Megaport's services – that is, using Megaport's channel partners, such as Cisco, who has over one hundred thousand customers and thousands of sales reps, selling Megaport's services (as part of a wider offering), delivering Megaport significant operational leverage over their largely fixed cost base. However, this tailwind ended up as a headwind, as Megaport's own sales reps had to spend their time educating and upskilling the sales reps of these channel partners, explaining how to sell a Megaport service – instead of spending their time closing deals themselves.

From the tone of the above discussion, you might be thinking that Megaport is growing at an anaemic rate, however as you'll see from the chart below, this is far from the case.



Monthly recurring revenue ("MRR") grew **+35%** YoY to A$12.4 million at Dec-22 (or +27% in USD terms), compared to their key cloud partners Amazon's AWS and Microsoft's Azure which grew revenues +20% and +31% respectively for the Dec-22 quarter (though from a much larger base than Megaport's).

In contrast to the major cloud services providers – whose customers are equally likely to be a large multinational corporation or a bootstrapped startup – Megaport's services prove to offer their greatest value to large organisations with data and applications stored and hosted in multiple locations spanning on-premises and/or cloud-based environments. So, while Megaport benefits from the continued growth of the cloud, its Network-as-a-Service (NaaS) platform can be much more difficult to sell than the cloud. This is likely due to a variety of factors including a more niche addressability to large enterprises, as well as:

a) the larger average size of the organisations that Megaport sells to, increases the number of stakeholders included in the buying decision, causing the sales cycle to lengthen;
b) the underlying complexity of networking; and
c) the NaaS market is more nascent than the cloud market – which is not surprising given AWS, the leading cloud, was founded in 2006 versus Megaport in 2013.

Despite being the leading independent NaaS provider in terms of network footprint, breadth of services, customers, cloud on-ramps and revenues, Megaport's brand is still relatively unknown amongst the end users that need it most – that is, the big four consultants (Deloitte, PwC, EY and KPMG), and their government clients. This compares to the cloud which has a large network of independent consultants and app developers supporting the growth of the ecosystem and providing additional utility for Amazon's and Microsoft's offering.

While Megaport has had a few one-off successes on the partnerships front, including a long-standing relationship with data centre operator Digital Realty, they still have a lot of work to do before awareness of their offering is anywhere near that of the cloud.

We believe the recent investments Megaport has made in making its services easier to sell and manage through PartnerVantage and MegaportONE, as well as product integration-partnerships with large organisations such as Cisco, will help bridge some of this gap, however increased investments in marketing may also be needed.

Nonetheless, at the core of the Megaport business is a great product solving a big problem felt by many large enterprises with distributed workloads. With Megaport's recent growth moderating to 'only' the mid-to-high 20s in percentage terms while at the same time battling several strong headwinds (caused by both external and internal factors), we are left salivating when we think about what they might be able to achieve once those headwinds ease (or even reverse direction). With enterprise data and workloads continuing to migrate to the cloud over the next 10 years, we find it hard to make the case that demand for Megaport's services (which are key enablers of cloud connectivity) won't significantly increase well into the future. Additionally, with Megaport's network expansion largely complete in key regions, port utilisation rates still quite low (at 39%), and the 100Gbps backbone upgrade largely complete, customer growth can be supported with little incremental capital investment needed. Thus, we're highly likely to see a major inflection in Megaport's cash flow generation over the next few years as they grow customers and service consumption to utilise the network capacity they've already invested in.

While we don't debate that Megaport's management and execution could have been better, we would always rather own a company selling high-quality products that have structural competitive advantages with attractive unit economics and a sizeable growth opportunity than a low-quality business with high-quality management. It's far better, in our opinion, to own a great horse with a bad jockey than a bad horse with a great jockey – you can always change jockeys!

To that end, Megaport has just appointed Michael Reid, a seasoned and proven sales executive from Cisco's network analytics subsidiary, ThousandEyes, as CEO – to replace the outgoing CEO, Vincent English. Though we are yet to meet Michael, we're hopeful that his relationship with Cisco and his extensive experience in selling IT solutions to large enterprises will both add value to Megaport's partnership efforts and help with stabilising Megaport's sales team.

The confluence of these (solvable) short-term issues caused Megaport to trade at a price far below what we think it's worth, and thus, we modestly increased our holding in the company towards the back end of the March quarter. Though, with a (more than) fully invested portfolio, these purchases had to be funded by reducing our interests in SIV Capital (SIV.ASX), Li-S Energy (LIS.ASX) and PPK Limited (PPK.ASX). As is our process, we made these decisions by carefully considering the qualitative and quantitative characteristics of each business, the returns achievable and the risks ahead – finding Megaport to be a more attractive opportunity for our capital at these prices.

Turning to Marmalade, another record quarter across all key metrics was achieved, shown in the table below[1].

[1] Active Supplier is defined as a Supplier who in the last 30 days has issued an invoice with Marmalade as the payment service
Gross Payment Value (GPV) is defined as the value of payments received by Marmalade and matched to an invoice.
Total Invoice Value (TIV) is the value of invoices created by Active Suppliers.
Gross Invoice Value (GIV) is the value of invoices with Marmalade payment details created by Active Suppliers.
Gross Cashed-in Value (GCV) is the value of invoices cashed-in by Active Suppliers.

		Mar-22 Qtr	Jun-22 Qtr	Sep-22 Qtr	Dec-22 Qtr	Mar-23 Qtr	YoY %
Active Suppliers	#	68	92	93	102	114	+ 68%
Gross Payment Value (GPV)	$ millions	18.8	33.4	46.7	56.1	53.0	+ 182%
Total Invoice Value (TIV)	$ millions	38.1	63.2	75.1	80.4	85.4	+ 124%
Gross Invoice Value (GIV)	$ millions	27.7	43.9	57.3	67.1	71.8	+ 159%
GIV / TIV	%	72.7%	69.5%	76.3%	83.5%	84.0%	
Gross Cash-in Value (GCV)	$ millions	9.3	13.9	19.1	19.8	21.1	+ 126%
GCV / GIV	%	33.8%	31.7%	33.3%	29.4%	29.4%	
Revenue	$	257,346	400,147	630,549	669,010	731,750	+ 184%
Average cash-in fee % of GCV	%	2.76%	2.87%	3.30%	3.38%	3.46%	

Though it's worth noting that as a payment service, Marmalade experiences the same seasonality in volumes as their small business Suppliers do, with January and part of February being much quieter periods for trading activity in general. Nonetheless, growth was still strong with GCV of $21.1 million in the Mar-23 quarter, up +126% on the Mar-22 quarter (or ~$84.5 million in annualised volumes).

Marmalade went live with MYOB, the second largest cloud-based accounting software provider in Australia, during the Mar-23 quarter. With these additional accounting platform integrations (MYOB and Quickbooks), Marmalade has increased the number of small businesses they can access by +44% to ~2.12 million, roughly ~88% of the 2.4 million small businesses in Australia[2]. While this assists in increasing their serviceable addressable market (SAM), and perhaps the efficiency of their sales and marketing efforts, it also helps to reduce their dependency on Xero to access and service customers, an important step for de-risking Marmalade's execution against the large opportunity in front of them. With 114 small businesses using the Marmalade platform as of Mar-23, accessing $84.5 million in annualised payments on-demand, it's mind boggling to think of what they could achieve should they acquire and retain even a small portion of those 2.12 million businesses. From our research, there's many thousands of businesses out there that should be using Marmalade to receive invoice payments – they just haven't heard of it yet. But we hope this will begin to change, as we've spoken to many Marmalade Suppliers that have referred their customers, suppliers, and mates to Marmalade, some of which have signed up – an impressive dynamic which speaks volumes about the value of the platform to small businesses.

When comparing Marmalade to the swathes of other financial service businesses, it's hard not to get excited about the opportunity. There's no other receivable that 'turns over' as quickly as B2B trade credit receivables, providing the opportunity for the highest returns on capital without being exploitative or a 'payday lender'. Additionally, by being first and foremost an integrated payment service in small business workflows, Marmalade has an opportunity to create flywheel growth opportunities as they seek to convert Payers of the invoice into Suppliers. This integrated nature also ensures that Marmalade is not easily swapped out for other alternatives, providing a switching cost that will make it difficult for competitors to pull customers away from Marmalade. Contrast this with lending products (such as residential mortgages) where there is little to tie the borrower to the lender, resulting in a commoditised product competing on price.

[2] Sources: ASBFEO small business counts, Xero H1'FY23 results, and MYOB and Intuit press releases.

In addition to these attractive attributes, there are few financial services markets that are as big (or valuable) as Marmalade's payment on-demand opportunity. Fewer still allow the lender (or provider of capital) with the opportunity to insure themselves against loss. Speaking of which, Marmalade recently signed an agreement with an insurer of trade credit, which will help provide an additional layer of protection from bad debts associated with Payer credit risk (though it does not offer any cover from Supplier fraud risk). All of this, in our view, places Marmalade in a unique and strong position to generate significant value for its shareholders.

Also of note, the team at Marmalade made progress on the capital front throughout the quarter, receiving offers from multiple lenders that will allow growth to be supported by debt capital, rather than solely relying on shareholder equity. Going through the extensive due diligence process with sophisticated lenders and coming out the other side with offers in hand reflects positively on the maturity of Marmalade with respect to its risk management capabilities.

In a capital-intensive business, access to debt capital is incredibly important for improving returns to shareholders, however too much debt can cause disastrous results when a major loss event occurs. For instance, an indirect competitor of Marmalade's, invoice financier Earlypay (EPY.ASX), had a major loss event occur late last year as their largest customer (representing ~7% of their receivables) went into voluntary administration. At the same time, EPY had financed their ~$430 million in gross receivables[3] with ~$370 million in net borrowings, implying a leverage ratio of ~86%[4]. While they remain solvent and liquid after this event, the market value of their shares has been severely marked down as a result of both the significant expected loss of capital and loss of confidence in the company's ability to prudently underwrite and profitably grow their receivables book.

Employing a high-risk strategy, such as using excessive financial leverage to fund growth and maximise short-term shareholder returns, is akin to picking up pennies in front of a steam-roller – risking solvency to squeeze a couple of extra percentage points in return, just doesn't make sense. While shareholders can experience more dilution if less debt is used, the trade-off is a much stronger balance sheet, a more resilient business and greater durability in long-term shareholder wealth.

You've got to finish the marathon to have a chance at winning.

At Marmalade, we're blessed with a management team who is acutely aware of the risks in running a financial business whilst also having significant skin in the game to align them with long-term owners. Through the many conversations we've had with the team, as well as conversations with (and research on) other indirect competitors, we're confident that Marmalade's underwriting capabilities are sound and their capital management is conservative, all of which are key characteristics of a financial service business that is a built to last well into the future.

To change tack, many of you might have heard, a 'short report' was released by Hindenburg Research, a well-known fund that make bets 'against' companies (hoping they will fall in value), about a core holding of ours, Block (SQ.NYSE). We spent a considerable amount of time towards the end of the March quarter going through each of the allegations against Block and comparing them with our own independent research and deep knowledge on the company and the broader payments industry it operates in.

[3] As at 31 December 2022
[4] Source: EPY.ASX H1'FY23 Results. Net borrowings = Total borrowings + Debtor finance payables – Cash

Throughout our research process, we seek dissenting opinions and actively try to avoid confirmation bias, so thoroughly analysing Hindenburg's research was a great opportunity to test and 'break' our thesis and conviction on Block. While they have brought the attention of a mainstream audience to issues and risks in Block, it should be noted that these issues and risks are widely known by those analysts that are experienced in the payments industry – leaving us wanting, after reading the report from such a well-respected short seller. Our conviction in the belief that we own one of the highest quality payments businesses in the world remains unchanged. We will make our review of the Hindenburg Research report available on the website in due course, but if you would like a copy to read before then, please reach out to Brock or myself.

Though, Block isn't the only one of our holdings being 'attacked' by short sellers. As Megaport's issues unfolded over the last twelve months, it too has ascended the ladder to be the second-most short-sold company listed on the ASX, with over 11% of issued shares held short as of April 17, 2023[5]. Whilst it's not intentional on our part to hold such heavily shorted companies, it is nonetheless reflective of the poor sentiment towards our core holdings and a key reason for the depressed unit price we're experiencing.

We understand it's not comfortable to see the unit price hovering at current levels, however by the same token, there has not been any deterioration in the future prospects of the businesses we are invested in and the competitive position of their products or services that they sell. Accordingly, we feel we are being offered the opportunity to invest at prices that will produce handsome future returns – and we are doing everything we can to capitalise on that opportunity.

To describe the value that a unit in the fund offers, our investments are currently producing approximately $1.09 in annual revenues and $0.60 in gross profits (both on a per unit basis) which at the current unit price of $3.6422, implies revenue and gross profit yields of ~29.8% and ~16.4% respectively – despite achieving recent revenue and gross profit growth of 62.1% and 88.1%, respectively. While an owner doesn't take home gross profits (there's many other bills to pay) you can rest assured that at current prices, you're getting incredible value for what you own.

Thank you for the opportunity to invest on your behalf.

Kind regards,

Luke Trickett and Brock McCamley
Blue Stamp Company Pty Ltd

[5] Source: Shortman – MP1.ASX

Performance Summary (Lead Class units)

	Mar-23 Qtr	FYTD	1 year	3 years	5 years	2-Mar-10*
BST^	(8.94%)	(1.29%)	(55.38%)	(2.67%)	2.66%	11.57%
Benchmark	2.50%	7.50%	10.00%	10.00%	10.00%	10.00%
AOAI	3.61%	13.61%	(1.06%)	17.27%	8.79%	7.84%

^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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