BLUE STAMP
COMPANY

22nd February 2024

Blue Stamp Trust Portfolio Composition

I don't wish to sound dramatic, however this may be the most important letter that I will write to you as a Unitholder in Blue Stamp Trust, so please take the time to read it through.

I'm writing because the composition of assets in the Trust has changed materially, in a manner that requires disclosure.

Below I have described everything that I think is relevant for you to understand the situation, framed around key questions you may ask. This is what I would expect if I were in your position. However, if you feel there is anything that I've missed which is important for you to consider, or if anything remains unclear, then do not hesitate to contact me and we will discuss further.

Getting to the point, the weight of Marmalade as a proportion to the total assets of the Trust has increased materially. At the end of December 2023, Marmalade comprised ~37.6% of the Trust's total assets and is now our largest position.

While the Trust has the capacity to invest in any security that is consistent with delivering long term compounded gains, our approach has centred around acquiring positions in listed companies.

Marmalade as a business, and the Trust's investment in Marmalade, differs from a 'typical' listed company in a number of ways.

1. Being privately held (i.e. unlisted), Marmalade does not offer the same degree of liquidity as a listed company would. This means the Trust's ability to realise the value of its investment in Marmalade at the prevailing market price will take longer to occur and may present a new risk – that the price realised is different from the market price.
2. Marmalade is still a relatively young business. It is not yet profitable and the Trust is Marmalade's largest shareholder. This means Marmalade's future equity capital requirements will firstly fall onto the Trust. While we experienced a similar situation in 2019 as we undertook the process of acquiring a significant shareholding in Silver Chef (SIV.ASX), we must ultimately recognise, this dynamic increases the risk profile of the Trust, as Marmalade is an unlisted company, so its access to equity capital is more limited than a public company and again, falls more significantly onto the Trust. Though helping to mature beyond this capital dependency, Marmalade is well progressed in discussions with a private credit fund, as it looks to support its future growth through the use of debt funding, rather than solely equity funding.

3. Marmalade was started by myself, based on my knowledge of traditional financial services and technology-led businesses such as Xero, combined with Lib and my experience of running a small business for over 15 years, where we lived through the pain caused by late invoice payments. It quickly became apparent that the problem Lib and I faced was not unique to us, as poor cash flow constitutes the leading cause of business failure in Australia and the leading cause of poor cash flow is… the net terms associated with invoices. Having entrenched, old-world financial services, co-exist with new tools that allow innovative services to be built on top of, creates significant opportunities for new value to be generated – and so, Marmalade found its way into the Trust.

Again, all of these differences (versus an investment in a listed company) and the inherent risks and opportunities caused by these differences, are amplified due to the increased portfolio weight that Marmalade now represents.

How did this occur?

Recognising a core tenet of the Trust is alignment of interests, I elected to have Marmalade as an investment in the Trust from its earliest days. This helped mitigate the risk of my personal interests splintering from those of Unitholders – essentially, I did not want the situation to arise, whereby my personal financial situation could be doing well, while Unitholders' may not. However, to balance this with the above-mentioned risks that occur with an investment in an early-stage, unlisted business, the Trust's portfolio weight of Marmalade was kept to a relatively small level, at or below 5%.

This changed over FY23, when the Trust's largest Unitholder, a US-based institution, chose to redeem their Unitholding. While this US investor was well aware of the Trust's investment in Marmalade (from the time of Marmalade's commencement), there had been an almost clean sweep in the US institution's investment team, where six of the seven people that were involved in the due diligence process over Blue Stamp, had left in a short space of time.

At the time of their initial investment, there was a near perfect overlap between Blue Stamp's investment philosophy and that of the US investor's. However, when over 80% of the team departs in short order, almost everything resets, irrespective of how long or stable their prior investment philosophy and allocation of capital once was.

As for Blue Stamp, ever since its commencement in 2010, our method of allocating capital has been distinct, with the main characteristic being the high degree of portfolio concentration we have had. While we have never sought to be concentrated (we would gladly hold 100 positions if we felt we could understand them in enough detail and they otherwise fit all the criteria we look for), portfolio concentration has naturally stemmed from the following factors:

a) the number of businesses and industries that we understand and have any degree of certainty around their future economic characteristics over the long-term is relatively few;

b) the number of businesses that we believe, with high conviction, will have favourable economic characteristics over the long-term and that aren't plundered by sub-par management is far fewer still; and

c) the number of businesses that offer expected returns that far surpass both our benchmark and other opportunities in the portfolio without materially adding to the risk of permanent capital loss in the fund is a small pool of a small pool.

Over the years, our investing, and consequently the investments we have made, have evolved, but most importantly and most fundamentally, our philosophy (of long-dated investments into companies with sustainable competitive positions that will produce a durable and growing stream of future earnings) has not wavered in the slightest and continues to be the focal point that the arc of our investing follows.

It is our view, that a long-term investor that does not evolve their craft and push themselves to expand their area of competence is no place to have your capital allocated. However, to push and challenge yourself, let alone the status quo, is to put yourself in a vulnerable position. But without this drive for progression and improvement and the preparedness to look and sound different, there is no opportunity for new and additional value to be created and the only conclusion is corporate and professional death. This drive for progress is something that Blue Stamp not only expects from each of its investee companies, but also of itself.

We have conviction in our investment philosophy because we know that to deliver attractive long-term returns in a manner that is replicable and scalable, then you must be prepared to make long-dated investment decisions that see a shareholding as akin to a joint venture with a business partner, or co-ownership. However, this intention to make long dated investments will come to naught if the Trust's underlying Unitholders don't also share the same mentality. Accordingly, we will choose to manage capital that is aligned with our philosophy and deflect those dollars which are not – even if that means being a fraction of the size than otherwise.

Consequently, a divergence occurred when the US investment team was reset, but Blue Stamp remained resolute with its philosophy and the investment arc it was on.

When the US investor redeemed from the Trust, we consciously chose not to fund any of their redemption proceeds with the sale of Marmalade shares. This caused the value of the Trust's listed investments to fall, while the proportional weight of Marmalade grew.

Compounding this further, Marmalade's operations, customers, payment volume, revenue, gross profits and most other metrics have all been tracking higher – and at a fast clip – as has been discussed in each of the quarterly letters. Naturally, this has driven an increase in Marmalade's share price and in turn, the value of Marmalade in the Trust.

The last compounding factor that has caused Marmalade to be a greater portfolio weight, was the Trust's decision to participate in a recent capital raise that Marmalade undertook, as it looks to continue to fund its near-term growth with additional equity capital.

It's also worth pointing out, that our decision to allow these factors to materially increase Marmalade's portfolio weight are commensurate with the very close knowledge we have over Marmalade's growth and operational performance, leading to conviction in the business's competitive position, market opportunity and its ability to generate significant returns for the Trust in the years ahead.

What do we see for Marmalade?

As mentioned above, Marmalade is solving the number one problem for Australian small and medium sized businesses (SMBs) – cash flow – by focusing on the root cause of the problem, being the unreliability and intrinsically risky nature of invoice payments.

Historically, there has not been such a thing as an 'invoice payment company', despite the payments industry being so (over) developed and the volume of trade that occurs via invoices and bank transfer being so large. The absence of innovation in the invoice payments space is largely two-fold; firstly there has not been the means to intermediate an invoice payment at scale (until cloud accounting was so ubiquitously adopted by SMBs) and secondly, the problem space is so severely difficult (key aspects being, the heterogeneity of the SMB market, the inconsistency of business processes adopted by SMBs, the malleability of an invoice and the many different paths an invoice may follow, the asymmetry of information between the two trading parties and the 'invoice payment service', the commercial sensitivity between the two trading parties, the prevalence of risk – either credit or fraud, the transaction size, etcetera etcetera…). But this difficulty does not make the problem disappear, it merely creates a high barrier to clear, to be able to enter the race. In this sense, size or incumbency do not assist a challenger. We have heard from multiple Australian banks, including the largest bank and non-bank providers in the space, who have voluntarily disclosed their inability to develop this service.

To build a product that can scale across a market with these characteristics, Marmalade has been spending years learning (often painfully), iterating and reshaping itself in a manner that sees it integrated into the daily operations of its customers (called Suppliers, in Marmalade lexicon). Importantly, solving an existential problem for an SMB through the position of an integrated component, is far more strategically valuable over the long term, than is opting to develop and deliver a simpler service, such as lending, that doesn't require the same level of technology investment, cross-functional interconnectedness and ultimately, patience. If we think long-term, then opportunities open up to solve problems and create value that are not available with a short-term mindset.

So, while the problem space is difficult, the rewards for the winner are immense, as Marmalade's cash-in product offers the greatest return on assets (ROA) of any financial underwriting product that operates in a large domestic or global market, allowing Marmalade (and its owners) to compound capital at rates of return and lengths of time that have not before been possible.

This is the profile of what we look for in a company, and on top of that, there's no other business that we know better.

How will we manage the position going forward?

As was flagged in prior Unitholder letters, we investigated how we might amend the structure of the Trust to allow a 'side-pocketing' of its shareholding in Marmalade, in order to mitigate the risk of Marmalade not being recorded at its current market value. However, this structure was not feasible.

Accordingly, we will do our best to ensure Marmalade's valuation is marked-to-market at least once per year and will communicate clearly when this occurs. If Marmalade continues to grow strongly and protect its margin, we expect Marmalade's valuation will increase and consequently drive the unit price higher. Likewise, if Marmalade fails to grow or fails to protect its margin, then this will likely cause Marmalade's valuation to fall, leading to a fall in the unit price.

If we feel Marmalade's value changes from what the Trust has it recorded at, then we will prevent new capital from entering into the Trust. We will seek to communicate this as far in advance as possible.

We will not restrict the liquidity of your investment in the Trust and prevent you from redeeming your investment, partially or wholly, at any point in time. There are a number of avenues the Trust may take to provide this liquidity to you, including the development of a nascent secondary market for Marmalade shares, following the recent capital raise Marmalade undertook.

Looking somewhat deeper into the future, Marmalade intends to become a publicly listed company by July 2027, though this is subject to significant operational risk, financial risk and risk of prevailing market conditions – to name a few. Should this come to pass, the risk of Marmalade not being held at its prevailing market price would be mitigated, along with the liquidity constraints from holding a private asset (subject to any initial escrow commitments the Trust may need to adhere to).

We will keep you updated with Marmalade's progress toward this key milestone.

Is anything else changing?

Given the importance of Marmalade for the Trust, along with my familiarity of the product and its opportunity, I will move full-time into the position of CEO for Marmalade, while simultaneously, Brock will move into the position of Portfolio Manager of the Trust – a role which he has largely been doing for the past year, in parallel with myself.

This move will see Brock responsible for future Unitholder communication, prioritising the Trust's research schedule (i.e. determining which stock to investigate next), leading the Trust's investment analysis activities, along with the all-important role of allocating capital in a manner that is consistent with the Trust's investment philosophy and investment objective.

I first met Brock in June 2020, and he joined the following month as Blue Stamp's first (and only) analyst – other than myself – to help cover the ground that we needed to be covering in order to find the next great investment. At that point, I'd been looking for someone for around five years and knew exactly what I was after – someone intelligent, with a passion and intensity for investing, a clear thinker with an eye for detail, recognising the importance of fundamental research and analysis, someone able to hold their own opinion and challenge anyone else's, but yet be open minded enough to consider and possibly accept an opposing point of view, an enterprising and entrepreneurial individual, willing and wanting to work at an unknown place (non-brand name) that had purpose, rather than a known place without purpose. They would need to have experience in the industry, but still be early enough in their career so they remained malleable and not brittle from years of conformity with industry dogma.

I never advertised for the role, as I felt the person (if they were out there), would find me… I felt like I was on the right path, as the people that kept reaching out, largely fit the profile (but weren't showing the affinity that I feel you need with investing). When I first met Brock, I thought he was sharp and comfortable to hold his own, even at the age of 23. He'd had experience working at a stockbroking firm, but like me, he knew his passion was on research and allocating capital, rather than generating transactions. He was persistent and I eventually offered for him to come in (unpaid) for two weeks, to see what he had. I put him to work on Afterpay. In my analysis and reconciliation of all of Afterpay's financial statements since 2015, there was one anomaly I had found – when back solving the movement in Afterpay's working capital between the years 2018 and 2019, there was a $4.5m discrepancy between their balance sheet, income statement and cash flow statement (it was insignificant, ~3% of OPAT, but it frustrated me). Brock solved it in his first week. He also showed a 'knack' for understanding money, or more specifically, the allocation of capital in equity markets – as Buffett put it, a 'money mind'.

Brock has now been working with Blue Stamp for over three and a half years and has shown both a steady hand and decisive action through some challenging market conditions. I have also seen his investment analysis skills grow, driven not by me, but his own hunger to reflect on past mistakes, learn and improve in order to deliver the best result for Unitholders.

Blue Stamp has a Portfolio Manager in Brock, that is just like me, only much better, and 14 years younger… all of which steepens the potential gradient of our unit price curve and lengthens our runway for compounded gains (by about half a generation), which could result in more than 10x our money, as compared to being just left with me (no pressure Brock). Now we just need to work out how to extend our life expectancy by 14 years.

All of this will mean that my time allocation to the Trust will be adjusted to reviewing and helping to guide Brock.

Regarding my role in Marmalade, I will be focused day and night on ensuring the business not only succeeds but carves out a dominant position in the financial services landscape by solving the most important and wide-spread problem amongst SMBs, that in turn, allows it to compound capital at rates and over horizons that are unmatched elsewhere.

Given the interconnectedness of Blue Stamp and Marmalade, I have never been paid a dollar of remuneration from Marmalade. However, as Marmalade continues to mature and drive toward break-even, together with a material amount of new equity raised by Marmalade coming from shareholders that are not Blue Stamp, I will seek to be remunerated by Marmalade (on approval from Marmalade's board) in line with market rates.

I will also be investing personally into Marmalade, to ensure my money follows my words and actions. While an investment directly into Marmalade is not to the *letter* of Blue Stamp's third tenet of alignment, it is entirely consistent with the *spirit* of the third tenet, as my money continues to follow the same investments that Unitholders' money is exposed to.

In light of this, what are my options as a Unitholder in the Trust?

You can remain on as a Unitholder. In this case nothing will change with regards to the processes of the Trust or your investment in it.

If you feel the Trust is no longer aligned with your financial situation or needs, then you may redeem and we will pay out your full Unitholding in cash, including your proportional ownership in Marmalade. If you would like to partially redeem, then we will again ensure the redeemed amount is fully paid out in cash.

Importantly, we do not intend to ever close the fund to redemptions. Ensuring Unitholders retain access to the value of their investment is of the highest importance to Brock and myself. However, if between now and when it may become publicly listed, Marmalade's valuation grows significantly faster than all other investments held by the Trust, then your ability to realise the full value of your Unitholding in cash, on a monthly basis, will likely diminish. Again though, the antidote to this potential limitation around the liquidity of your Unitholding, is for Marmalade to become publicly listed itself.

If, having had the opportunity to absorb this information, you would like to redeem partially or wholly, we kindly ask that you indicate your intention to do so, as soon as conveniently possible. This will allow us to ensure the portfolio holdings remain stable and as desired given the expected returns at current market prices.

Summary

I wrote in the FY21 annual Unitholder letter:

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

This point I was trying to make, was not entirely complete…

Value and Growth, by themselves, are superficial concepts at best, two-dimensional objects that do not add a vast amount of depth (or wealth). But when Growth and Value co-exist in the same opportunity; that's when the magic happens for those long-term investors focused on compounded gains.

To speak more plainly, Value by itself might provide a short-term boost, but nothing ongoing or enduring, much as we experienced over the years 2010 to c2013 as we supplemented our investing activity with arbitrage opportunities created via takeovers. In this case, a single arbitrage transaction could simplistically be characterised as *Value*, and these investment opportunities typically occur over a short duration.

Recycling capital from one arbitrage transaction into another is an attempt to increase the duration (and consequently the generation of wealth) and could be considered *Value with Growth*, however time will show that neither of these forms of Value are a scalable way to compound capital over the long-term – which is Blue Stamp's sole focus.

Growth by itself, as we have seen in recent years, is vanity at best. Being loaded up with short-term driven venture capital money, many early-stage companies were blinkered into pursuing growth in headline metrics, without regard for building longer-term shareholder value – particularly if that required the business to grow slower. It also hasn't been uncommon to see even mature, listed companies seduced into courting cosmetic growth metrics such as return on equity or earnings per share, at the expense of their return on assets, slowly diluting longer term shareholder value. While *Growth* in this manner can be considered over a longer duration (think about how long interest rates remained at levels that were zero or near-zero), time will eventually reveal the lack of value-generation and shareholders will not achieve attractive long-term returns.

However, when capital is allocated in a manner, within a business, that is focused on 'pouring concrete' and building the foundation for sustainable and monetisable (directly or indirectly) product differentiation, then the conditions have been set for shareholder *value* to flourish over time. If that recipe is repeated consistently enough to produce a *growing* stream of earnings that equals or outstrips the growth of capital invested, then those shareholders won't have to do anything other than nothing to become fabulously wealthy – irrespective of what the market thinks at any moment in time. For this type of business, time will be its friend.

Marmalade offers the Trust an investment where *Growth with Value* is prevailing. That we can also purchase a share of Marmalade at a good price, makes it all the more compelling for the Trust.

When establishing the Trust through 2009 and 2010, I was very clear with myself that I wanted to ensure my energy and my creative endeavours would always remain fused together with the Trust and continue to compound capital for Unitholders. I wanted to ensure that there would always and only ever be one investment fund that I established and was responsible for. And I wanted to ensure there wouldn't ever be a splintering of my time and focus to interests that weren't aligned with the management of capital that Unitholders had entrusted me with.

Having Marmalade begin its life in the Trust was a conscious decision to remain true to these resolutions, all of which remain so today as Brock and my roles mature into what is required to deliver the best outcome for Unitholders.

Thank you for the opportunity to invest on your behalf.

Kind regards,

Luke Trickett