PURE ASSET MANAGEMENT

# Investor Newsletter

**Period to: 30 September 2022**

# The Income and Growth Fund

Dear Investor,

We enclose the September 2022 update for the PURE Income and Growth Fund.

The PURE Income and Growth Fund is open for investment.

## Foundation Class Portfolio Returns (After Fees)

The PURE Income and Growth Fund returned -1.6% in September 2022.

| | 1 Month | 3 Month | 6 Month | 1 Year | 3 Years | Since inception |
|---|---|---|---|---|---|---|
| **Returns (%) p.a.** | -1.6% | -2.1% | -3.1% | -3.9% | +15.6% | +14.5% |
| **St Dev (Annualised %)** | | | | 4.7% | 14.0% | 12.7% |
| **Sortino Ratio** | | | | | | 3.1 |
| **Sharpe Ratio** | | | | | | 0.8 |

**After fees and assuming reinvestment of all income distributions. Fund inception 21 December 2018.*

| Fund overview as at 30 September 2022 | |
|---|---|
| **Funds Under Management** | $148.9m |
| **Since Inception Annualised Return After Fees (Foundation Class, Dist. Re-Invest)** | +14.5% |
| **Foundation Class Current Unit Price (Ex. Distribution)** | $1.2527 |
| **Total Distributions Paid After All Fees** | 38.1cpu |
| **Number of Investments** | 29 |
| **Average Loan Size** | $4.3m |
| **Weighted Average Portfolio Interest Rate** | 10.1% |
| **Total Establishment and Arrangement Fees Paid to Investors (Gross)** | $3.6m |

| Current Portfolio Exposure | |
|---|---|
| **Fixed Income** | 67.6% |
| **Equity/Warrants** | 13.6% |
| **Cash** | 18.8% |
| **Total** | 100.0% |

### PURE online application form

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**www.puream.com.au** contact@puream.com.au

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# Portfolio Summary

The ASX Small Industrials Accumulation Index fell 10.5% for the month of September, as the world's bond markets tanked on speculation that the crises of: energy, inflation, and geopolitics; is fast evolving into a financial system stability crisis.

Against this backdrop the Fund fell 1.6% as our listed equity and warrants dropped in value, mirroring the wider market rout. The Fund's exposure to listed instruments at the end of the month was 8.1%. It is the fact that we retain exposure to the upside, but with limited capital at risk, that has protected investors in 2022, with the Fund down 3.8% year-to-date, versus a fall of 26.6% in the comparable Index.

We continue to work to deploy capital against this market backdrop for the following reasons:

1. We have been overweight cash since mid-last year and although we have been right to be cautious, we are not paid to sit on cash.

2. Overall cash weighting in the portfolio since inception has weighed on performance. Our investments have delivered a return of +100%, but the Fund has delivered +68% to investors.

3. We don't believe that we, or anyone else, can *time* the market consistently.

4. The share prices of companies we are looking at are now down than 50%-80% from their 12-month highs. We acknowledge that the counterfactual to this proposition of *value* is that historical valuations may have been inflated and therefore wrong. However, we are not just measuring value by references to share prices, but also by applying a future multiple to the earnings forecasts provided by our borrowers. We can illustrate the power of this changed pricing environment below.

Investors often ask if we have changed our lending terms given current conditions. The answer is yes, but only marginally. Our Warrant premiums have moved down a little and the interest rates have moved up a little, but what is far more important is that the share prices are much lower.

We are investing in high growth businesses. We are typically funding what they expect to be an inflection point in their growth, either:

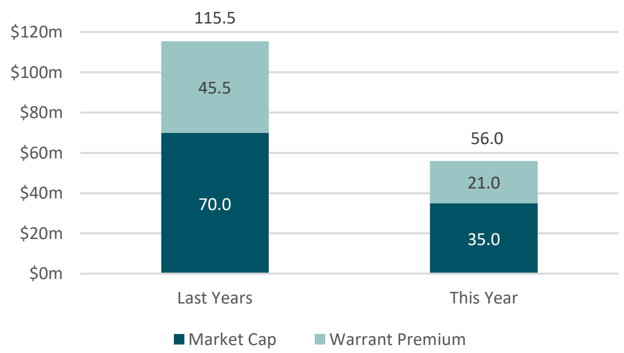
- organically, or
- through a new initiative (e.g. a new factory or joint venture); or
- via M&A.

Managements' growth expectations are therefore high, and typically range from 25% per year, to over 50% per year. Most companies we talk to are in structural growth phase and although not immune from the economy, their success will largely come down to execution.

The first point to note is that the fall in the Companies' market cap, means that the percentage uplift from our warrant premiums is off a much lower base valuation. Even at this lower premium our offer is compelling, indeed it is even more compelling now, due to the attraction of dilution savings it offers versus raising equity.

For illustrative purposes we show below, how following a 50% decline in the share price, even with our premium, we are still getting exposure to the equity at a lower valuation than equity investors were paying in previous years ($56m vs $70m).

Valuations: Last Three Years vs. This Year

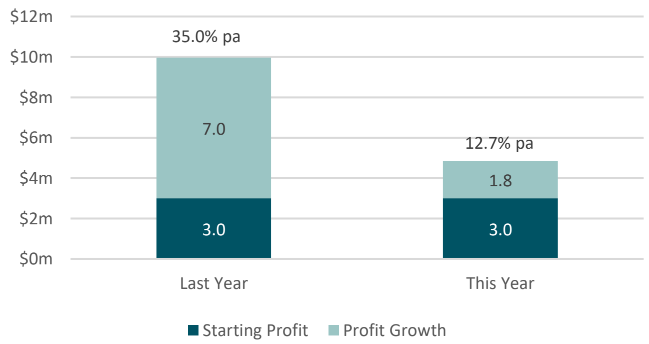



We target a +18% return p.a. on all investments, so we can deliver a 15% return to our investors (after cash holdings and fees). This is made up of Interest & Fees, and the expected return from the equity (warrants).

As we have said, these are high growth opportunities, often with our funding as a catalyst, but with the much lower starting valuation the earnings growth required to hit our targeted equity return over the four years, is now far lower.

Again, for illustrative purposes, we show that, because of the much lower starting valuation, to achieve the same equity return, we would now only require 12.7% p.a. growth in profit for a Company that would have previously been required to exhibit 35.0% p.a. growth.

### Profit Growth Required: Last Year vs This Year

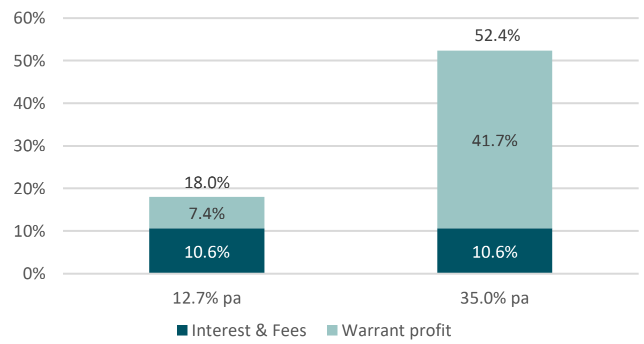



We would not invest in a Company that was expecting to generate less than 20% growth per annum, and 35% p.a. is not an uncommon management forecast. This means on the lowered valuations we are now experiencing, we have a significant margin for safety compared to management's expectations.

Finally, to demonstrate the leverage, we show how this new pricing environment provides upside if the Companies can execute how they hope.

In this example, we again show the that the Company only need to hit 12.7% p.a. growth for the Fund to reach its targeted return of 18% on each investment. However, if the Company does achieve its 35.0% p.a. targeted profit growth, from our lower entry price, our annual return on investment jumps to 52.4% p.a.

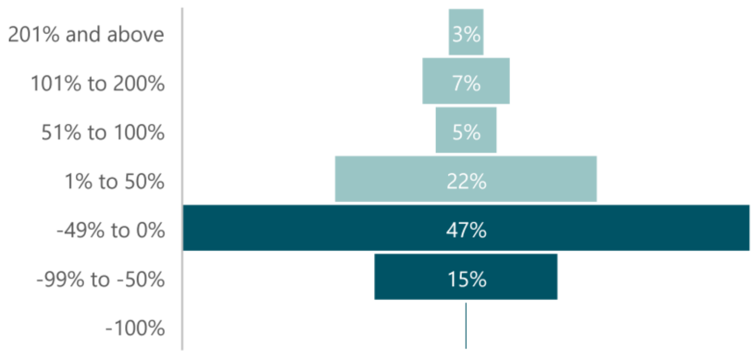
### Earnings Growth Outcomes: To Reach PURE target vs. If the Company hits its objectives




Naturally we do not expect all our Companies to hit their targets, indeed most don't. Although good due diligence helps to avoid the pitfalls it seldom allows us, or indeed any investors, to consistently pick outstanding winners, due to so many negative external factors and execution errors, from which all companies suffer.

We do not believe in the *cult* of the star stock-picker, nearly all active managers fail to consistently outperform peers. Picking stocks is extremely difficult, as is demonstrated by the chart below which shows that the dispersion of the returns from shares across our target cohort of industrial companies. As you can see, between FY19 and FY22, 63% of shares suffered negative returns.

Distribution of target company cohort returns (FY19-FY22)

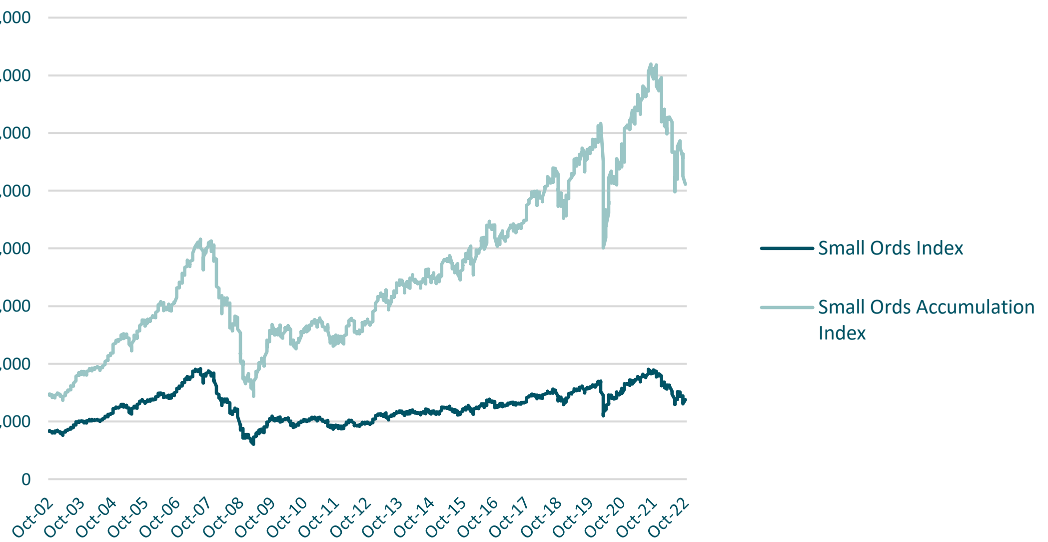



Even with the advantage of credit level due diligence, we are not banking on being better stock pickers. We are betting on the fact that we have a superior investment instrument (hybrids versus equities).

It is this approach to investing that gives us a competitive edge. Our investments won't lose money often and we get paid interest. Notwithstanding the fact that only ~70% of our funds are interest bearing (ex-cash, warrants and equities), this interest return alone easily beats the long-term return of the stock market.

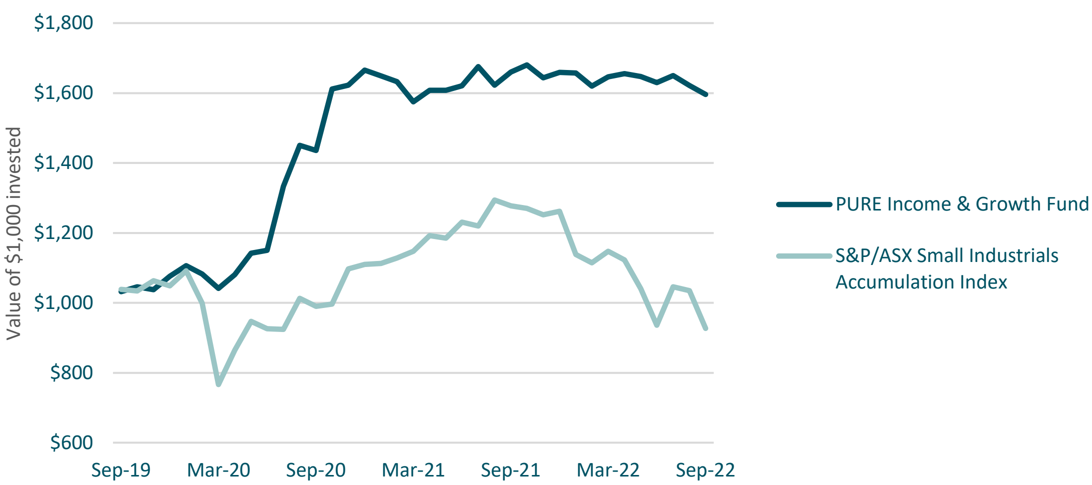
It is worth dwelling on this point for a moment because most people's perception is that the long-term stock market return is somewhere between 6% and 8%. This is correct, the Small Industrials is 6.4% (CAGR), but it includes reinvestment of dividends and benefits from the power of compounding. The actual capital growth of the Index is much, much lower, and over 20 years, excluding reinvestment, is just 2.6% (CAGR).

20-year Returns of ASX Small Ords Industrials (with and without dividends reinvested)




Our job is to keep *placing informed bets*, and although we don't know which ones will deliver super returns, we know that some will; others will deliver solid returns; some will only deliver us interest; and, occasionally, we will lose money. The aggregate should be consistent outperformance of the stock market.

Three-year relative performance




# Distributions

The PURE Income and Growth Fund will pay a distribution for the period ended 30 September 2022. A 1.3 cpu distribution was declared for the Foundation Class, and a ~1.20 cpu distribution was declared for the Platform Class. In the coming days, investors will receive their distribution statements from Mainstream, outlining the distribution received per unit invested. Investors who have elected to reinvest their distribution will have their units reinvested on 1 October 2022. Investors who elected to receive their distributions in cash will receive the payment in the coming days.

# Fundraising

Market conditions have become extremely favourable to PURE's hybrid investment strategy.

When valuations have declined markedly but you're not sure if there's still more to come, exposure to convertibles can be a great way to:

1) not miss the upside should markets or an individual equity exposure begin to perform, whilst,
2) minimising your exposure to further drawdowns, and
3) getting paid to wait for the equity thesis to perform, through the coupon of the debt

Or put another way – why try and catch the proverbial falling knife when you can get paid to wait for it to hit the floor and bounce?

We believe equity-like returns can be earnt via credit instruments possessing upside optionality. As such, both PURE Funds are actively raising capital over the coming weeks to facilitate an expanding pipeline of opportunities.

We are determined to capitalise in these conditions. As such, the PURE Income and Growth Fund is actively embarking on a fundraising campaign. If you would like to invest with the PURE team, please access the online application form via the Olivia123 link below:

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The greatest compliment our investors can give is the referral of friends, family and associates. If you know of other investors who are seeking additional investment opportunities, please feel free to contact us at any time.

We thank you for your support.

Nick, Mike, Tim, Dan, Jonathan and Jean-Luc

PURE ASSET MANAGEMENT

## Monthly Returns – After Fees

| The Income and Growth Fund – Foundation Class | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Year | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | Fin YTD |
| FY19 | | | | | | 2.4% | -1.8% | 1.2% | 0.3% | -1.0% | 2.5% | 1.7% | 5.4% |
| FY20 | 2.6% | -1.4% | 2.1% | 1.4% | -0.8% | 3.8% | 2.8% | -2.2% | -3.8% | 3.8% | 5.7% | 0.7% | 15.0% |
| FY21 | 15.9% | 8.8% | -1.0% | 12.2% | 0.7% | 2.6% | -1.0% | -1.0% | -3.5% | 2.1% | 0.0% | 0.8% | 40.9% |
| FY22 | 3.4% | -3.2% | 2.3% | 1.2% | -2.2% | 1.0% | -0.1% | -2.3% | 1.6% | 0.5% | -0.5% | -1.0% | 0.5% |
| FY23 | 1.3% | -1.7% | -1.6% | | | | | | | | | | -2.1% |

| The Income and Growth Fund – Platform Class (APIR: PUA7226AU) | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Year | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | Fin YTD |
| FY21 | 16.0% | 8.9% | -0.9% | 12.4% | 0.7% | 2.7% | -0.9% | -1.0% | -3.5% | 2.1% | 0.0% | 0.8% | 41.8% |
| FY22 | 3.4% | -3.2% | 2.3% | 1.2% | -2.2% | 1.0% | -0.1% | -2.3% | 1.6% | 0.5% | -0.5% | -1.0% | 0.5% |
| FY23 | 1.3% | -1.7% | -1.6% | | | | | | | | | | -2.1% |

## Unit Price Data Download

Please click on the link below to download the updated unit price data for each unit class.

[The Income and Growth Fund – unit price data to 30 September 2022]