Investor Update

Q1.2023

Wunala Capital Emerging Opportunities Fund

The Fund invests in late-stage growth capital, bridge/Pre-IPO financing and select listed opportunities across high growth technology, financial services, data and digital companies.

Performance Summary

Net Returns	3 months	12 months	Since inception (annualised)	Since inception (total)
Wunala Capital Fund	**1.7%**	**-9.5%**	**8.4%**	**21.5%**
Benchmark (5% hurdle p.a.)	1.3%	5.0%	5.0%	12.1%
ASX All Tech Index	10.3%	-11.6%	-5.4%	-12.7%

Performance is reported net of all fees and assumes reinvestment of distributions. Past performance figures may be subject to rounding and is not necessarily a reliable indicator of future returns. # Cumulative returns from inception date of 31 October 2020.

The Fund returned +1.7% for the quarter. Gains were driven by the relatively small portion of the portfolio that is listed on the NASDAQ - the index was up 17% in this period, with our individual listed stocks comfortably outpacing this in aggregate. We had no private market revaluation events for the quarter. Combined, we continue to generate positive gains while having constructed our portfolio to reduce volatility and minimise the risk of a permanent loss of capital.

This investor update covers the following topics:

- Portfolio summary and notable transactions
- Finite vs. Infinite games
- Exits for the Ecosystem

Portfolio summary

As of 31 March 2023, the Fund had positions in 5 listed and 15 unlisted companies, although we have since exited two of the listed positions. The unlisted portfolio includes two investments made in 2022 - DataMesh and SendFX - both of which have performed strongly (and particularly in DataMesh's case where it has considerably exceeded even our rosiest assumptions to date).

None of our unlisted companies closed a transaction or funding round during the quarter, although several are in variously advanced stages of doing so anticipated to be at valuations in excess of our entry and/or current holding price. As a reminder Wunala's private market investments are held at the lower of cost, or where warranted, their written-down value to reflect public peer performance, unless there has been a recent material arms-length transaction.

We continue to see a large pipeline of transaction opportunities. Anecdotally it feels like there is a lot of 'stale money' tied up in late-stage private companies looking for an exit and will aggressively trade off valuation for liquidity. We are offered opportunities daily to 'rescue' an investor from themselves but to be honest this does not really move the needle for us, either in a risk vs. returns analysis or simply from a "do we get excited about this?" question.

We remind ourselves that there will always be a surplus of demand to finance rare and exceptional companies with a genuine prospect of compounding returns for a long period of time. Our focus is on unearthing those and putting our investor's precious capital to work in them, whatever it takes.

Finite vs. Infinite Games

One of my biggest concerns at the moment is that the Australian tech investment scene doesn't currently… work.

One concept I have found useful in how I approach the profession of investing is captured in the book "Finite and Infinite Games" by James P. Carse (and expanded on by Alex Danco who inspired this section). The book's core concept describes two types of interdependent activities (or 'games') - where other people's actions affect you, and your actions affect others:

- Finite games - each action you take is aimed at succeeding in a predetermined goal, i.e. winning. Examples include a game of football, political election, a war and so on. In each case the activity is defined and limited in scope and the outcome can be completed if all parties agree to do so.
- Infinite games - the game is played *for the purpose of continuing to play*. Think of this as something like learning about wine, assisting your community or enhancing the culture of an organisation. The best outcome is bringing new players into the game so that they can also play along.

I think the best way to make a lot of money investing in private tech companies is by playing an infinite game. The primary goal is to help build exceptional companies that can generate sustainable profits at scale. I don't think the alternative - setting out to 'win' the game of investing by defeating all other participants - leads to sustainable success. Paradoxically by prioritising the success of our companies first it often means delivering strong investment (out)performance along the way, but playing it as a finite game means ruining it for everybody.

Essentially our approach to investing is, to an absurd degree of reduction, a waiting game. Wunala seeks to invest in the very best companies, and support them as they compound over time. Exceptional companies will always have liquidity options as there are always buyers of great and rare assets, but the goal isn't to help build something focused on an exit - it's to help build something that is sustainable (which is itself desirable, hence we'll always have exit opportunities if and when we need them).

Most investors though play a finite game and are in it literally for the money and money alone. This is fine for traditional businesses (typically banks and miners, which makes up most of Australia's economy) which normally operate in a bounded, defined opportunity where you know what winning looks like. It does not really work for startups whose value is indefinite.

The structure of most private investment funds (venture, private equity etc) is limited by a fixed end date by which they need to return capital. The longer this return takes, the more the fund's IRR is affected, making it harder to raise a successive fund. This pushes them into a Finite Game - aiming to 'win' by showing an exit or revaluation quickly as possible. (This is a good time to remind the reader that Wunala is specifically set up as an open-ended fund structure to allows us to hold onto our compounding winners).

For many VC-backed companies, their growth was driven not by investors funding those companies to make sustainable profits over time, but by investors hoping they would *find someone else* willing to believe the company would do so. No investor wanted to become a 'bag holder', hanging onto their stake bought at a high price all the way through down a steep value decline - they want to move it on quickly to someone else, or bring another investor in to keep funding the cash burn required to grow (ideally at a higher valuation than they initially paid). The problem is twofold - first, that this incentive structure encourages growth for growth's sake, funding uneconomic companies that are simply getting larger just for the sake of it; and second is that right now there is nobody else to sell their "passable bags" to!

It feels like this misalignment of incentives has resulted in the Australian tech landscape largely becoming a series of hot potatoes - founders pass their equity on to angels, who pass it to seed investors, then VCs, then late stage/crossover funds and then to retail investors (often via a listing on the ASX). Ideally each later party catches a slightly cooler potato - it's less risky, so they will pay a higher price for it and thus reward the earlier stages who have been paid to take risk (as they should).

This approach still works for great companies - people keep on making money along the line. But increasingly it seems like the tech VC scene has broken down into a Finite Game and investors (all along the chain) are stuck.

Exits for the Ecosystem

To be clear I am not saying that there are no individual success stories, or no good investors, or situations where things worked out well. Canva is clearly something special, there are numerous other success stories such as Employment Hero, Safety Culture, Go1 and so on, there are a small number of thoughtful investors in private companies out there, and a few really promising companies I am excited about that we are tracking on the way up as well. But broadly speaking, right now you have a generation of investors who have largely been investing in passable bags which are now un-passable, and a generation of companies that have been burning cash to drive growth at growth's sake with little to no ability to generate sustained profits at scale.

One of the best ways to clear the logjam of late-stage private companies is to increase the ability for investors to exit their holdings. I imagine that many non-natural backers of these types of companies would be delighted simply to break even or take a moderate loss to get out. Either way it clears the decks and removes from the ecosystem certain investors who arguably should never have been in these companies to begin with, leaving it to the infinite game players to take onwards.

The Australian tech investment market has grown significantly in the last 10 years but is still a fraction of the scale of Silicon Valley. The universe of exit opportunities for late-stage (Series C onward) tech companies is basically i) list on the ASX (which to be fair is one of the friendliest, large, well-respected exchanges globally for this purpose); ii) find a strategic/trade buyer or iii) conduct a secondary sale to another fund.

Previous Wunala newsletters have explained the factors why the IPO market is currently shut for the time being, but every cycle turns, and I am confident this will reopen at some point. I am less confident about predicting exactly when this would be, but to quote the great Rachel Hunter from a Pantene shampoo commercial in approximately 1990 "it won't happen overnight, but it will happen". Likewise strategic M&A - as the economy stabilises, large incumbents will increasingly regain their appetite to buy promising startups once the FOMO (fear of missing out) returns and they realise they are better to buy than build. Finally, as mentioned earlier, exceptional companies will always find a way to generate liquidity on attractive terms for their investors, including by bringing in new investors.

The achievements of the Australian tech industry in rapidly scaling from a global minnow to a generator of world-class talent and success is not to be diminished. We are so close to making it a truly sustainable environment and just need to ensure that we are all doing so in the right way (and for the right companies) so that we can keep bringing others in to play the game, and play it right.

And safe to say, I believe that at Wunala we are doing exactly this. If you're a founder building something durable and scalable, or if you're an investor looking to back these types of companies, we'd love to talk.

Next window for applications

We are currently open to new applications from now until 30 June 2023. We will be conducting a series of in-person presentations across May and June - please contact us if you would like a personalised briefing on the Fund, its strategy, portfolio and current opportunities.

Thank you again for your interest and support of Wunala Capital.

Scott Wilson
Managing Partner

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E: info@wunalacapital.com.au **T:** (02) 9199 5064 **W**: wunalacapital.com.au

Wunala Capital Pty Ltd | Level 1, 377 New South Head Rd, Double Bay NSW 2028 | CAR 1281806 of AFSL 238198