Investor Update

Q3.2022

WUNALA CAPITAL

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

Returns	3 months	12 months	Since inception (annualised)	Since inception (total)
Wunala Capital Fund	**6.1%**	**-2.6%**	**12.0%**	**24.3%**
Benchmark (5% hurdle p.a.)	1.3%	5.0%	5.0%	9.6%
ASX All Tech Index	2.4%	-37.2%	-12.9%	-23.3%

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

The Fund returned +6.1% for the September quarter, despite ongoing volatility and broad negative sentiment globally. The listed portion of our portfolio was up modestly over this period, but the larger share of gains was driven by the unlisted portfolio. Despite a sustained chill in private market funding and several high-profile write-downs of non-portfolio companies (i.e. Canva), several of our companies raised new money at a premium to our entry price, increasing our carrying value.

This investor update covers the following topics:

- Portfolio summary and notable transactions
- Price discovery in private markets
- Structure is sexy (again)

Portfolio summary

As of 30 September 2022, the Fund had positions in 5 listed and 13 unlisted companies. We did not make any new investments in the quarter, an outcome with which I am entirely comfortable. Our investors allocate their precious capital to us to make good decisions; sometimes the best decision is to take no action (as opposed to making no decision). Instead, I prefer to wait for something firmly in our sweet spot to come by - and it always does, even though the timing as to when this will be can be unpredictable when measured in short increments. I would rather do no deal, and preserve capital and optionality, than be stuck in a bad position just because I felt I had to do 'something'.

Of our existing portfolio of unlisted companies, five executed some form of transaction during the quarter. For better or worse (spoiler alert: generally for the better) this had the effect of providing transparency on the valuation of that company. As discussed later, price discovery can be tricky in the private markets, so we think that having ~40% of our private portfolio's carrying values independently validated in a quarter when the IPO market is dead is a strong signal. (Our remaining private companies are held at the lower of cost, or where warranted, their written-down value to reflect public peer performance).

Investors in the fund will receive a separate, detailed portfolio update, but Q3 highlights include:

- Exits: one portfolio company was acquired by a strategic investor, with our convertible note redeemed in cash
- Up rounds: Xpansiv and Crimson were revalued upwards to match their latest funding rounds (plus one more company which raised a structured round at a higher implied value, albeit still held by us at cost)
- Round extensions: another company raised an extension to their recent round at a flat valuation

Price discovery in private markets

Over the last quarter the topic of how to fairly, accurately and swiftly value an illiquid private investment came to some prominence. In Australia, superannuation pension funds have become larger investors into private capital (both direct and via funds) but there is a natural mismatch between their need for frequent pricing feedback vs. the lack of transparency and consistency in applying a valuation framework to unlisted assets. (Note that in the US, crossover funds like Wunala that invest in both private and public companies are much more established, and the regulatory framework has developed to become quite strict in mandating public market comparable valuations to private assets which largely reduces this mismatch).

More generally though, prices convey information, and information can be thought of as a display of expectations. Furthermore, markets are not efficient, and prices can therefore overshoot due to hope or undershoot due to fear. In any case prices are the primary method of providing feedback to investors on the outcomes of their decisions. For the last 9 months or so, a sharp pullback in valuations has provided feedback that has been almost overwhelmingly negative. In the listed market that feedback is given daily by what someone would pay for a particular security; in the private market (which lags public) that information has been slower to escape.

We consider the most accurate valuation method is to consider a recent, material, arms-length transaction led by an outside investor. Outside of that, as almost all our portfolio is late-stage (i.e. close to being IPO ready at least) there are usually a reasonable set of comparable public companies that we use as a direct comparison to check that our private valuations are reasonable and in line with how a dispassionate market would view them.

One side note: our working assumption is that there are a number of private companies who are reluctant to seek out a 'true' price discovery process as they may not like the feedback they will receive. Conversely, there are those companies who are confidently seeking out this data to validate their success and raise further capital at a higher valuation. In this case, no news may mean two things: the company has plenty of cash, a long runway to execute and is keeping their heads down building a future leader; or they have no incentive to be realistic about their lowered valuation as the negative implication of failure can often become a self-fulfilling prophecy. In the latter case this can often lead to a public 'keeping up of appearances', but if (when?) it runs out the end can be sudden and terminal (absent a crunching equity recap) as we have occasionally seen in some external situations to date. Working out which case applies in a given instance is something we spend a lot of time considering.

Structuring (or the devil in the detail)

Many investors in our primary area of focus (late-stage growth and pre-IPO funding) are experiencing their first proper bear market. For the last 13ish years, prices have typically only gone up and the scarcity mindset switched from "availability of capital" in 2008 to "how do I find good ideas" over the last decade. With the balance of power tilted to founders, investors would need to compete amongst themselves to be chosen as the preferred partners - but invariably the factors considered would be less around the value-add or relationship benefits, and more around speed, high valuation and lack of friction.

Structure was often the first thing to fall by the wayside - in order to compete with others, investors would position themselves as overly founder friendly and forego due diligence, checks and balances, governance and other critical items to ensure capital was stewarded appropriately.

In today's market, in order to maintain an upwards valuation trajectory (or even to maintain a flat round), expect investors to bring these back in vogue. A quote we've heard a few times in one way or another is "tell me the headline valuation you need, and I'll tell you the structure to get it done". Liquidation preferences (participating & non-participating), penny warrants, minimum IRR floors and the like are starting to appear in more term sheets. While this may preserve the veneer of an up round, the true returns for an investor in the same company may vary wildly depending on the eventual exit type and consideration.

Invariably this benefits the last money in, with the right to be the first money out (to the potential detriment of others). This preferential treatment appeals to our optimistic yet risk-averse nature, but in any case we maintain all stakeholders in mind. A key tenet of our approach is to be trusted partners for our portfolio companies and to work constructively to deliver a profitable and satisfactory outcome for all parties.

Looking forward

As foreshadowed in our last quarterly newsletter, after sitting on the sidelines for almost a year we are finally starting to see sensibly priced (and structured!) investment opportunities in companies with strong revenue generation that have near-term catalysts and liquidity events. Our pipeline anticipates closing at least 2 new transactions before Christmas, both of which make us very excited. We continue to believe that our investments made during this trough will deliver attractive returns through the cycle.

As a reminder the fund's current intake window closes on 31 October 2022, subject to capacity. If you would like to learn more, please see our application form online or reach out to us directly or on the details below.

Finally, a personal note. Two new babies were born to families of the broader Wunala team during the last quarter - welcome Freddie and Ziggy. While our investment team is busier than ever, our professional focus has not wavered and as ever is dedicated to protecting and growing your capital.

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

Scott Wilson
Managing Partner

Footnotes

1. Index references are used for comparison only as the Fund is not measured against this for its calculation of performance fees.

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