PURE ASSET MANAGEMENT

Investor Newsletter

Period to: 31 August 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 -1.7% in August 2022.

	1 Month	3 Month	6 Month	1 Year	3 Years	Since inception
Returns (%) p.a.	-1.7%	-1.5%	+0.1%	-0.1%	+17.1%	+15.4%
St Dev (Annualised %)				5.1%	13.9%	12.7%
Sortino Ratio						3.3
Sharpe Ratio						0.9

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

Fund overview as at 31 August 2022	
Funds Under Management	$150.4m
Since Inception Annualised Return After Fees (Foundation Class, Dist. Re-Invest)	+15.4%
Foundation Class Current Unit Price	$1.2863
Total Distributions Paid After All Fees	36.8cpu
Number of Investments	26
Average Loan Size	$4.4m
Weighted Average Portfolio Interest Rate	10.0%
Total Establishment and Arrangement Fees Paid to Investors (Gross)	$3.6m

Current Portfolio Exposure	
Fixed Income	67.2%
Equity/Warrants	14.9%
Cash	17.9%
Total	100.0%

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Portfolio Summary

August proved an intriguing month as hawkish central banks sent bond yields higher. Be it complacency, equity markets ignored this messaging until Federal Reserve members placed an exclamation mark on their intentions at Jackson Hole. Jerome Powell effectively ended the bear market rally with his comments, a selection of which are shown below.

> *"The Federal Open Market Committee's (FOMC) overarching focus right now is to bring inflation back down to our 2 percent goal."*
>
> *"Price stability is the responsibility of the Federal Reserve and serves as the bedrock of our economy."*
>
> *"Without price stability, the economy does not work for anyone."*
>
> *"We will keep at it until we are confident the job is done."*

While many equity investors entered FY23 positioned for a central bank 'pivot', it's now clear policy makers will prioritise inflation over growth. With this in mind, volatility is here to stay, with capital remaining scarce and expensive until such time as either (a) markets get clarity on industrial earnings, or (b) industrial valuations become unequivocally attractive.

Regardless of the outcome, this represents an optimal backdrop for the PURE Income & Growth Fund deployments over the coming quarters.

The Fund delivered -1.7% in August, a disappointing month largely driven by a Company specific events. These are discussed in a range of portfolio updates below.

Ellume Health (Private)

Ellume, a Covid testing Company, has two operating businesses, one in Australia (the head company) and one in the US. The Australian business entered Voluntary Administration during the month as it could not meet creditor payments. The US business is still operating and since the Company went into administration, has won a $US46.5m order from the US Government for additional tests (3.1 million).

The Company is now up for sale, with a New York based investment bank likely to handle the process. Considering the new US Government order, we think the likelihood of full capital recovery is high but have provisioned the position in August to reflect the fact the Australian business remains in Voluntary Administration. There is reasonable evidence that suggests we're being overly cautious, which we will discuss, but would rather err on the side of conservatism until more information is forthcoming.

Background to Ellume

Ellume Health is a Queensland-based point-of-care diagnostics company, which produces the world's best rapid Covid diagnostic test for consumer use. In addition, Ellume has a portfolio of other products for rapid and low-cost diagnosis of other conditions at various stages of commercialisation.

Ellume's Challenges

Ellume has suffered several issues since we helped fund the Company: one self-inflicted and several improbable and exogenous.

The self-inflicted wound is:

1. A product recall. Late last year, just as Omicron was raging and demand for testing was peaking, the Company suffered a product recall because a third-party biological component was throwing off the accuracy of the tests. At the time the Company had demand from all the leading US pharmacy chains and was selling +US$50m of product per month, at high margins. This was a failure of Quality Assurance testing, but because the Company could not be sure which tests were affected, it was forced to recall +0.5m tests sold and write-off a significant proportion of finished inventory. This was very expensive, but more importantly, caused a hiatus in sales, right at the point of peak demand when the Company could have captured over US$100m in cash profits.

The exogenous factors are:

1. Free tests. Shortly after funding, the US Government announced plans to provide 500 million free Rapid Antigen Tests, this was later upgraded to one billion. Initially we were *high-fiving* this news, but it subsequently became apparent that Ellume would not qualify for this demand. Despite being a supplier to the US Government and building a US facility at their behest, the Company was at the time supplying from Australia and domestic production was mandated to qualify for the order. The availability of free tests decimated what remained of retail demand.
2. Omicron. Although highly transmissible, Omicron's impact was more transitory than most scientists predicted. How much this was pathological or due to prevention (testing, precautionary measures and immunity), we don't want to speculate, but by February 2022, the opportunity had passed.
3. US Government. Our thesis on Ellume was underpinned by significant evidence (not least of all a US $120m grant to build a manufacturing facility in the US), that the US Government considered Ellume's products to play four important roles:
    i) To provide 8.5 million tests (an US$140m order) for its own distribution, earmarked at different times for: the US defense forces, civil servants, and the consumer market.
    ii) To provide capacity to supply the US Government with additional tests for its own distribution i.e. follow on orders
    iii) To provide additional production capacity to meet consumer demand.

iv) To be a long-term solution to pandemic preparedness, both to be better equipped to fight this pandemic, but also to have a *warm* manufacturing base for future pandemics. This policy envisaged the US Government providing a long-term supply contract to build a stockpile and in doing so maintain the financial and operational integrity of suppliers. Ellume's product is uniquely suited to pandemic preparedness because it is quick, accurate, and due to its digital connectivity, can provide health authorities with real time reporting to track infection spread.

Notwithstanding the recent order, what is so remarkable is that, apart from its immediate need, the US Government has pivoted so abruptly on its plans for pandemic preparedness. There is a US$10bn funding package stuck in Congress and Biden's Administration does not appear to be willing to expend political capital to ensure its safe passage.

Where to from here?

With the new US Government order the Company will be able to fund its ongoing operating costs, but it does not have enough capital to extinguish its creditors. We therefore expect the status quo of the Australian business in Administration and US business operating, to continue for the time being.

In the meantime, the Company will be appointing a US bank to conduct a trade sale process. We have every reason to believe that this will result in an offer for the Company, the proceeds of which should, in our view, result in a full recovery of the Convertible Notes holders' capital, of which we are a part.

We estimate the valuation the Company would need to achieve to ensure full recovery of our investment is US$125m (assuming the bidder takes over the lease liabilities).

The reasons we believe this is an achievable target are:

1. In July 2022, a large US investment bank that is seeking the engagement to sell the Company, valued Ellume in a range of US$300m to US$900m.
2. Based on the figures we have been provided, the Company will have +US$220m of assets (+US$270m including inventory), including the expected cash profit on this latest US Government order less operating costs. We are trying to verify the real value of these assets but would assume their value is largely contingent on the acquirer's assessment of their ability to produce cashflow, rather than their purchase price, which the balance sheet reflects.

   The Group's other liabilities are ~US$70m. Therefore, based on a going concern purchase, the Net Asset Value of the Company (ex-inventory and lease liabilities) is US$150m, versus Convertible Notes on issue of US$68m.
3. We have ascribed no value to the Intellectual property of Ellume. There are, however, several data-points to indicate that there is value to Ellume's IP. These are:
   a. Prior to the Covid pandemic the Company formed a relationship with GSK plc (Market Cap: US$54bn) to release a Home Flu test. The agreement was aborted due to the pandemic, however, it would have resulted in a substantial licensing agreement had it been consummated.

b. Qiagen NV (Market Cap: US$10bn), the world leader in tuberculosis testing, approached Ellume and provided funding, to convert its diagnostic product into a point-of-care platform. Qiagen has now launched this product and Ellume is the supplier of materials to the programme.

c. Ellume was the first company globally to be approved by the FDA for the home-testing of Covid. The FDA subsequently lowered the bar for the quality of the tests, which has allowed products, the likes of which we have all used, to enter the market.

d. The US Department of Defense was so enamoured by the pandemic monitoring capability of the product that it provided a US$260m package to support Ellume and had indicated the potential for billions of dollars of orders.

e. The Company has previously received indicative offers well in excess of the value required for full recoverability on the Notes, as recently as late 2021.

We are in constant dialogue with the Company and will keep investors up to date with developments.

FiscalNote Limited (NOTE.US)

FiscalNote

While exciting to have our first investment list on the NY Stock Exchange, we did hold concerns for short-term portfolio attribution. FiscalNote listed at $10 per share in August, and we were pleasantly surprised to see the stock close at $10.78 on 26 August. Gravity proved the winner into month end however, with FiscalNote falling 27% in the final three sessions on no news.

Although FiscalNote impacted returns in August (c. -0.5% at a portfolio level), the valuation is becoming attractive. Operationally the company has reaffirmed 2022 targets, has access to capital, and is exposed to structural growth of legal digitisation. As such, we see better times ahead for FiscalNote as it embarks upon life as a listed company.

At the prevailing share price the Fund has made an 27% profit on its investment, which we will look to liquidate in the year ahead.

Wellnex Life (Private)

WELLNEXLIFE

We have a modest (S2.5m) investment in Wellnex, a health products company.

With FY22 behind it, we are excited about the company's future prospects. Management has provided FY23 revenue guidance of $29m, a 56% increase on FY22. We consider this conservative. Post result, discussions with management suggest multiple initiatives with the potential to add significant shareholder value. Some of these are discussed below:

i) The recent acquisition of teeth whitening brand Mr Bright for $1.5m in scrip. Mr Bright delivered FY22 revenue and EBITDA of $4m and $800,000 respectively, with Wellnex seeing further upside as unpenetrated retail channels are engaged. At less than 2x trailing EBITDA, this appears to be an attractive acquisition.

ii) Strong sales of Wellnex owned brands Wakey Wakey and Wagner Liquigesics, along with the release of the Nighty Night and the Chemists Own brand.

iii) Strategic partnerships in both Australia and abroad for the licensing of Wellnex products.

iv) Near-term entry into prescription-based cannabis market under the TGA Special Access Scheme. Sales are expected from 3QFY23.

v) First-mover entry into the Australian over the counter S3 cannabis market. The domestic market is expected to be sizeable and have large barriers to entry, with Wellnex recently embarking on their goal of TGA approval. At a production level, a strategic partnership with with OneLife Botanicals provides access to a state-of-the-art medicinal cannabis cultivation and processing facility, while the distribution reach of Wellnex provides confidence in market penetration.

We are encouraged by the progress being made and will follow the Company's growth as the year progresses.

DXN Limited (DXN.ASX)

As previously reported, DXN received a $26m offer from Flow2Edge Pty Ltd Australia to buy the assets of the Company. The terms of this transaction were subject to both shareholder and FIRB approval, however the nature of the data centre assets was ultimately a matter of contention for the FIRB. As such, DXN updated the market earlier this month regarding a new proposal to sell the modular business for $20m, leaving DXN with the Sydney, Darwin and Hobart data centre assets.

The amended transaction is expected to be voted on by shareholders in November ahead of financial close mid-December. We see negligible FIRB risk under the second proposal, leaving shareholder approval the key outstanding condition.

Relative to the initial sale agreement, DXN must realise $6m in proceeds from selling Darwin, Sydney, and Hobart to achieve a like-for-like outcome. This remains highly prospective, in our view. For context, DXN paid a total of $7.6m for the Darwin and Hobart facilities, leaving some potential for upside risk relative to the original proposal. It's our working assumption these date centres are readily saleable to a range of potential buyers.

We look forward to keeping investors informed as the transaction progresses to closure.

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

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%											-0.5%

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%											-0.5%

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 31 August 2022