TANARRA

31 January 2023

Dear Investor,

2022 marked the end of the era of free money, an era in which it was hard not to make money investing in financial assets, where a lot of punters and speculators looked like geniuses. It's no real surprise that the end of the party in financial markets offered few places to hide.

If 2022 showed anything, it showed the enduring power of contrarianism in investing. Investors owning high multiple profitless tech stocks – the ultimate free money crowded trade - at the start of the year generally dusted two-thirds of their capital. Those who dared attract the near-universal opprobrium of owning fossil fuel stocks made 51% in the Australian market and 65% globally.

It also demonstrated the importance, for those with short investment time horizons, of getting the big calls right in a world increasingly dominated by macro events. With just two calls early in 2022 – go long commodities on the back of war in the Ukraine and bet on central bank tightening much more than market consensus – an investor could have shut up shop, spent the rest of the year learning a language or sitting on the beach, and finished up close to top of annual investment performance league tables.

I commented in last year's letter that crypto looked like an accident waiting to happen, and so it proved. While no one foresaw the specifics of the epic maladministration at FTX, markets that are non-transparent, poorly understood, unregulated, and which offer the opportunity to get rich quick, have throughout human history proved fertile ground for malfeasance. The bad news is yet to fully play out – it's unlikely FTX was the only bad actor. The good news is that transmission effects to other asset classes have been low because, as we noted last year, crypto even at peak bubble had thankfully not grown to a scale where its fall would imperil the broader financial system. Where crypto goes from here is anyone's guess once the web of undisclosed leverage, dubious collateral, double counting and even outright fraud is untangled – a lot of smart money continues to play in the space, and bitcoin prices continue to defy gravity despite the carnage in the sector. Central bank digital currencies remain a strongly possible end destination, but the transparency that would entail with governments and tax authorities is the last thing many crypto investors would want.

We also commented last year on inflation of valuations in venture capital land, and these too have had a reckoning with a higher cost of capital in 2022. We believe this has further to go, and that deflating venture capital asset valuations are in some respects the canary in the coalmine for unlisted asset valuations more broadly. For the most part, these continue to be held at cost or higher by asset managers, despite businesses having been bought at record multiples in recent years with cheap capital. Private equity-owned businesses face the prospect in the years ahead of being sold in an environment of valuation multiple compression, not expansion. The days of easy wins fuelled by multiple expansion and high leverage are probably over in PE, and asset managers are going to have to work harder for their returns.

Asset price correction is at face value not a great thing for investors in venture capital, but in the long run we believe it's healthy. Saner valuations and stronger pre-investment due diligence processes will in the long run attract capital into this vital asset class on a more sustainable basis. We are big believers in the importance of venture capital, and its ability to generate attractive returns for investors in the right environment – which was the reason we raised a ground-breaking new venture fund for the University of Melbourne in 2022, which I will discuss more fully shortly.

Entrepreneurship and venture capital are at the heart of the capitalist system and the progress of humanity. They're transforming our lives for the better, at the forefront of the world's biggest challenges – in healthcare, food security, fighting climate change, and space travel, to name just a few. They offer our kids an infinitely more interesting and varied array of career opportunities than the standard fare of my generation of working your way up in large corporations. Moreover, the spirit of start-ups and entrepreneurship has gone global, and the genie's not going to be put back in the bottle. Inspiring stories of start-ups creating something from nothing and changing the world in a positive way are the greatest global ambassadors for the projects of capitalism and democracy that are so widely feared to be under threat from authoritarianism and nationalism. They're reasons for profound long-term optimism.

There's no doubt however that the world around us offers plenty of reasons for worry from a financial perspective, and more importantly from a humanitarian perspective. Nothing comes close in this regard to Russia's invasion of Ukraine. I spent time last year in Europe and it was almost beyond imagination to contemplate the appalling atrocities and threats to human life taking place there daily, less distance away than a Melbourne to Darwin flight. I thought this was a world we had left behind. It's made even more surreal by the fact that life continues largely as normal elsewhere, albeit with higher energy costs.

Some of the perceived risks to the world economy may be overplayed, rising protectionism and de-globalisation among them. While Covid played havoc with global supply chains encouraging re-onshoring, and the Biden Administration's Inflation Reduction Act has clear protectionist overtones, global trade and supply chains will continue to grow long term, with a few detours and reversals along the way. Trade and supply chains will just look a bit different, with more dispersion around Asia and less concentration in China. Meanwhile, the China re-opening story should be a good one for the world economy in 2023.

No one knows where inflation and interest rates will settle, central bank governors included, so it would be foolish to make predictions. While the outlook seems to be brightening, I would note three things.

One, the consensus estimate for the increase in Fed Funds rate at the start of 2022 was 100-125bps. The Fed beat that by a factor of three. So be careful with consensus views and conventional wisdom. I was too anchored myself by consensus predictions this time last year.

Two, markets are generally pricing inflation and rates to ease materially in the second half of 2023, leading to a quasi-Goldilocks soft landing environment. It's easy to see how that could be overoptimistic, much harder to see how it could be excessively pessimistic. So risk is probably to the downside. A key tenet of investing is not trying to be the person with the infallible crystal ball; that person doesn't exist, it's scenario imagination and risk management that count.

Three, if interest rates do settle at below 5% as the market seems to be discounting, Bernanke, Yellen and Powell deserve to be elevated to the stature of Paul Volcker as all-time great Fed Governors. Navigating the world through the most dangerous financial blow-up since the 1920s plus a pandemic, triggering the epic amount of money printing those events unleashed, and have rates settle at less than a third of their peak in the late 1970s with no depression or even sustained substantial recession, will be an achievement for the ages. It looks within reach.

Even with rates that remain modest by historical standards, the end of the era of free money is reasserting the role and impact of capital markets in national and corporate financial management. The Truss Government in the UK discovered this to its cost. The return of financial markets to pricing capital in what should be a rational manner is a good thing, something to be welcomed. It's an important counterweight to the era we are now entering which is being described with some justification as the era of Big Government – where the public expects governments to provide much more than in the past, and where governments are inclined to intervene to a much greater extent in free markets. New government spending is economically beneficial where it takes the form of investments genuinely supporting economic growth, but not so where it has dubious productivity returns such as tax cuts for the well-off or blowouts in public service wage bills that don't translate to improved community services levels.

When the consequence of increased government expenditure and market intervention was essentially costless (at least in the short term), the political cost to governments seeking popularity was low. When financial markets impose a cost, that's less likely. This can limit the unintended consequences of government actions or the cost to future generations of an endless pile-up of public debt by governments that will be long out of power when the bill comes due.

Likewise, financial markets that return to their traditional role as rational allocators of capital in the corporate sector, and which discriminate once again between good businesses and poor ones, serve to grow the overall economic pie. In economist-speak, they minimise capital wastage and maximise allocative efficiency. So a higher cost of capital world brings good things with it, even though it will impose stress on mortgage holders. No stress remotely close to 1991 thankfully, an important difference we shouldn't lose sight of when markets are worried about upcoming fixed rate mortgage rollovers.

We at Tanarra remain strongly positive on the outlook for Australia. Even though two of our biggest exports, iron ore and coal, face declining revenues in the years ahead, the country can look ahead to a very bright future. In many ways a golden age beckons. Our population growth, location in the growth region of the world, critical mineral resource endowment for the energy transition, rising knowledge economy, low national debt by world standards, world's best superannuation system, stable and honest institutions, transparent regulation and strong national work ethic, position Australia as not only a great place to live, but to invest as well. Hard to beat really, with a dose of greater economic dynamism.

These are reasons why we believe Tanarra, as a leading alternative asset manager based in Australia, offers a compelling value proposition to domestic and international investors.

We fortify this confidence in our value proposition by an investment ethos that seeks to invest in asset classes which offer attractive returns from innovation and differentiation. Ours is not the standard fare of benchmark-hugging conventional strategies.

For example, we invest in public companies through our Long Term Value Fund, but only where we believe we can add value to the investee though our strategic or financial skills – acting as a PE-type shareholder in public companies. There is a large gap in Australian public markets for this kind of strategy, and we have the largest fund dedicated to this type of investment approach.

As noted briefly earlier, in 2022 we raised an A$100m venture capital fund for the University of Melbourne called Tin Alley Ventures, the first-ever university-specific venture capital fund in Australia. We were delighted with this achievement against the backdrop of the negative sentiment towards the venture asset class during the year, especially so given it was a first-time fund. The University of Melbourne is Australia's #1 university, #34 in the world, and great companies such as Cochlear have emerged from its research halls in the past, but the opportunity to scale up its commercialisation activities is substantial. We believe it is of national economic significance that greater value is captured from the intellectual property generation from our world class universities, and that this value – funded largely by Australian taxpayer dollars - is realised in particular for the benefit of Australian superannuants and investors.

The Tin Alley Fund draws on our extensive experience investing in and with the largest such university fund in the world, Oxford Sciences Enterprises, and makes what we believe are some important improvements to that model. Full credit to Vice Chancellor Duncan Maskell and his team at UoM who conceived and drove this initiative. Tanarra is the majority shareholder in the TAV fund management entity, with UoM owning a minority stake.

In 2023 we will raise an Australia/NZ PE fund focused particularly on partnering highly prospective companies in their growth ambitions and in helping Australian companies grow into Asia, especially in partnership with founders who want to take their companies to the next level. This builds on our multi-year track record in this space. The Fund is anchored by a substantial pre-commitment received in late 2022.

In credit, Tanarra Restructuring Partners build its team in 2022 and has seen a strong increase in deal flow. The fund is well placed to meet stressed companies' needs resulting from Covid impacts and the end of free money. Our performing credit arm, Tanarra Credit Partners, began investing its second fund. We are focused on scaling up the business in 2023 and believe it offers a compelling, defensive counterweight to other asset classes as a low volatility, high cash income product offering.

More broadly in credit, we are seriously interested in forming a fund or capital pool to enable the provision of long term debt on reasonable terms to Australian industrial companies. Australia has the world's best superannuation system which has become a huge national asset, and yet there is a hole at its heart in the form of the absence of long term debt for Australian industrial companies, even investment grade ones. Our companies have to rely disproportionately on short term bank debt or equity finance, or go offshore to markets like the US private placement market if they want long term debt. This has serious hidden costs to our companies and our economy. Time and again when there have been significant disruptions in financial markets, Australian public companies race to issue equity on a vastly greater proportionate scale than in comparable international markets - Australian companies issued more equity in 2020 than did all the listed companies in the US and UK combined, relative to market cap. In an environment of short-term uncertainty, this was a rational response by boards of companies with short-dated bank debt maturities or higher gearing ratios to address the risk that debt would not be able to be rolled over, or that covenants might be temporarily breached. The consequence, however, of such actions is that equity is issued at the worst possible time, causing serious dilution to shareholders unable to participate at a time of high economic or financial uncertainty (usually Mum and Dad investors). That's precisely the moment when long term debt in the capital stack would be of substantial value to companies, and to investors. Long term debt is a normal and uncontroversial staple of international capital markets; its absence here is a failure of imagination and courage, and frankly a national disgrace, given the size and strength of our superannuation system. The time for lunches and conferences admiring the problem has to be over; it's time to make it happen. The market environment is opportune as well given the lower outlook for equity returns in an era of higher cost of debt and capital.

We are happy across all our activities to advocate publicly for policy improvements that we believe will benefit Australia's financial markets and economy. In 2022 we made the case for non-executive directors (NEDs) of Australian public companies to own more shares in the companies they oversee. It reflects our belief in alignment of interests between those managing companies, and being paid for so doing, and the people on whose behalf the managing is being done. Company directors should have real skin in the game through a shareholding that is genuinely material to them personally. On average Australian NEDs own shareholdings that is one third of the after-tax value of cash fees they receive from their businesses they direct. We believe it can and should be more, and there are tax effective ways to do this that don't disenfranchise younger directors or those with lesser means whose involvement in public company boards – traditionally a pretty closed club in Australia – would enhance boardroom diversity. We weren't surprised by the sound of one hand clapping that emerged from the NED community in response to our call – and even that may overstate the enthusiasm. It's not to question the bona fides or competence of directors in any way. We believe however that the prevailing culture where NED share ownership is widely regarded as a matter of "compliance" with the minimum required to meet company policy and get entry to the boardroom (usually one year's fees) is flawed. That mindset completely misses the positive signalling power to investors outside the boardroom from directors inside the boardroom having the conviction to buy shares in the companies they direct, and the eternal and universal merit in the principles of alignment of interests and skin in the game.

Ours is a people business. Great people and a good team culture are the essential requirement for success in an investment firm. I'm exceptionally proud of the team we've built at Tanarra, and the culture we've created, from scratch, in just seven years.

We made some very important hires and appointments in 2022. Given space limitations, I'll just mention the senior ones.

Matthew Brown joined us as Chief Investment Officer across all our strategies. Matthew is a young Australian who has returned from London to take up this vital role. In London he worked as a core team member at the Oppenheimer family office called Stockdale Street; he joined at the inception of the Oppenheimer's global portfolio following their sale of De Beers and had a key role in shaping the investment philosophy, process, team, and portfolio. Before that he worked with investment markets legend Mike McCaffery at Makena Capital in Palo Alto, learning the craft of endowment and long term investing. He has had exceptional experience to build on his academic record at Harvard, Oxford and UNSW, and his appointment was a very significant step forward for our firm. He is including some comments and perspectives below mine in this letter.

Towards the end of 2022 we were fortunate to hire Ravi Jeyaraj as Head of Private Equity. Ravi is an extremely capable private markets investor who immediately before joining Tanarra was Australian Head for the large Swiss investment group Partners Group, a role of real significance. Prior to that role he had a long and successful record in Australian PE with Navis Capital.

We were delighted to formalise the role of Tanarra Co-Founder and Principal Anna Shave as Head of Capital Partnerships for Tanarra, a role she has been doing informally for us to great effect to date.

Anna has been instrumental in the growth and success of Tanarra since inception. She will continue to be based in Perth and lead our efforts there, as well as remaining involved in selected investee companies.

This month we were delighted to secure the appointment of Dr. Andrew McLean as Managing Partner of Tin Alley Ventures. Andrew is also an Australian returning from the UK to take up this important role for Tanarra and the University of Melbourne. In the UK he was the Head of Life Sciences and part of the founding team at Oxford Sciences Enterprises. He was instrumental in several of their most successful investments and exits, including Vaccitech (Nasdaq:VACC, the company that was the co-inventor of the AstraZeneca Covid vaccine), and MiroBio (acquired by Gilead for $405m).

Our pro bono charity advisory arm, Tanarra Philanthropic Advisors, welcomed Anna McCann as COO early in 2022, joining inspirational CEO Lisa Kingman to take TPA's activities to another level. Anna's early career as a lawyer led to her role as Head of Pro Bono and Community at Baker & McKenzie. Anna has a strong sense of social purpose with a particular interest in helping the not for profit sector to be more efficient and effective. Anna served on the Board of Smiling Mind for four years and more recently, as COO of the Reach Foundation. She is an accomplished academic and holds a Law degree, a Science degree and an MBA.

Finally, we were honoured to appoint the esteemed former Chairman and CEO of Mizuho Financial Group, Yasuhiro Sato, to our Global Advisory Board. Sato san's achievements and roles in Japanese finance and business are incredible, matched only by his humility and modesty. They include serving as Vice Chair of the Japan Business Federation (Keidanren) and Executive Member of the Japan Council for Science, Technology and Innovation. He will assist Tanarra with his perspectives on the global economy and on international investor appetite in Australia. His appointment to our Advisory Board reflects our confidence in the enduring strength of the Japan-Australia relationship.

So, there's lots going on at Tanarra, and we look to the future with confidence and optimism!

I wish all our investors and partners well for 2023 and thank you most sincerely for your support.

John Wylie AC

CIO's Comments

I've had the privilege of working with John since 2011 as part of the Rhodes Trust Finance and Investment Committee. As a result, I've followed the Tanarra journey closely since its inception in 2016 and I couldn't be more excited to now be officially onboard. Tanarra's mission and vision is to be the number one diversified alternative assets investment firm in Southeast Asia, with "number one" being defined as the best not the biggest. We are at an inflexion point in this pursuit of investment excellence having reached more than A$3b in funds under management with a team of 38 people across five strategies. Many of our strategies are raising, or soon to raise, their second fund having achieved a strong track record in their first fund, and we are increasingly receiving inbound interest from high calibre international allocators. I am in admiration of what my colleagues have built to date and it's a privilege to join them for the next leg of the journey.

I've been fortunate in my career thus far to interact with and learn from some of the world's best investors. It has been a journey of constant learning and evolution. Since taking up this new role, I've spent a great deal of time reflecting on these learnings and how they might apply at Tanarra. I'd like to share just a few:

1. **The mission and vision are everything.** It is so critical that everyone at the firm knows where it is headed and that they are aligned to a common motivational purpose. This mission is the north star to guide investment and operational decision-making at all levels, from the reception desk to the CEO.

   Achieving Tanarra's mission will be no easy task. Exceptional risk-adjusted returns will clearly be required but these are "outputs" and not in our direct control. To achieve investment excellence, we must instead obsess over the "inputs" that are in our control – investment strategy, process, people, and culture – with a focus on constant, daily improvement.

2. **Clearly articulated investment strategy.** This helps everyone on the team to understand what the "fairway" looks like. It focuses time and energy and prevents people chasing dead-ends. Critically, it prevents the team from strategy drift and helps avoid the allure of enticing investments that sit outside the team's circle of competence (the cause of most large investment mistakes).

   Part of what makes Tanarra unique is our ability to work across asset classes and across the capital stack. This is mutually reinforcing because the insights we garner in one area serve to enhance our views in another. The presence of multiple funds increases the need to clearly define their investment strategies. This starts with a unifying set of core Tanarra investment principles that tie all of our funds together:

   - **Long-Term Mindset:** All of our strategies employ a long-term investment mindset, made possible by our patient capital base. We approach our investments with the same long-term mindset embodied in building the Tanarra business.

   - **Valuation Matters:** We seek to own assets at a discount to their intrinsic value to provide a 'margin of safety' (yes, this even applies in venture capital).

   - **Target Market Inefficiencies:** We target areas of market inefficiency where we can achieve alpha.

   - **Deep Fundamental Research:** We seek differentiated insight though deep proprietary research, always from first principles.

   - **Quality Improvement:** Our investment theses typically involve improving the quality of our portfolio companies / assets.

3. **The power of process.** A disciplined investment process with carefully designed frameworks guards against inherent biases and promotes consistency of decision-making across the portfolio and over time. It also serves to keep us on the fairway and to steady the ship in rough seas.

   As Tanarra scales, we are focused on the incremental addition of investment process while avoiding unnecessary bureaucracy. We pride ourselves on our flat hierarchy and the ability to be nimble.

4. **Learning organisations win in the long-term.** Learning is critical to personal satisfaction and sustainment, but its import is so much broader. It is not possible to become world class without constant personal, team, and organisational learning. It is what creates evolution and improvement of investment philosophy, process, skills, and judgement – all the ingredients that underpin success in our collective profession. Learning cultures start with intellectually curious, self-motivated individuals. However, to become a true learning organisation, people must dedicate time to share one's learnings with others to facilitate team learning. The team's knowledge should compound faster than any individual. It requires strong organisational focus to capture these learnings to evolve and innovate process (i.e. organisational learning).

5. **Do things from first principles – the blank page approach.** Starting my career in the military, I am well acquainted with the danger of a *"this is how it's always been done"* mindset. Too common in our profession, investment firms seek to copy other successful firms. Each firm though has different passions, circles of competence, and competitive advantages and the right philosophy and strategy is predicated on these core foundations. It follows then, that we should follow our own path and that blindly copying others is a route to failure. It can be a tough and lonely path with many questioning the wisdom of doing things differently to the herd.

   Tanarra embodies this in spades; it is built into our mission with the focus on "alternatives". This is easily seen in our public market engagement strategy, our venture capital partnership with the University of Melbourne, and in the ideas that John discussed above such as long-term private debt in the Australian market.

I am excited to be part of the Tanarra family and for the investment opportunity set in 2023 and beyond. We are facing the most significant macroeconomic, fiscal policy, and geopolitical uncertainty in the last 15 years. Although challenging, this type of environment is opportune for active managers with robust and disciplined investment processes who can develop differentiated sourcing and investment insight.

Matthew Brown