Columbus Investment Services Ltd
as responsible entity for Alternative Investment Trust
ARSN 112 129 218 ASX Code: AIQ (AIQ or AIT)

ASX ANNOUNCEMENT

24 September 2021

AIQ Supplemental Investor Update

Please find attached the AIQ Supplemental Investor Update

Authorised for release by Columbus Investment Services Limited ACN 095 162 931 AFSL 221183 (**Responsible Entity**), the responsibility entity of the Alternative Investment Trust, and Warana Capital Pty Limited ACN 611 063 579 AFSL 493579, the investment manager of AIQ.

For additional information on AIQ, including the latest fact sheet, please refer to www.thealternativeinvestmenttrust.com

For any enquiries please contact the Responsible Entity on 02 8277 0000.

The Investment Manager (the "IM," "Warana," or "we") of The Alternative Investment Trust (ARSN 112 129 218 ASX Code: AIQ) ("AIQ" or the "Trust") would like to provide the below supplemental investor update to assist existing and potential investors in their understanding and analysis of the IM's view of the favourable and unique characteristics of AIQ.

AIQ is a unique investment proposition not only in the Australian listed fund market but also in the broader context of the global investment fund landscape. We consider that the opportunity to buy unlisted absolute return funds at discounts to their net asset value in a tax efficient, listed vehicle sets AIQ apart from its peers. It's unique for a variety of factors:

- AIQ generally doesn't invest in the broader market with the expectation that such listed prices increase. Its core portfolio and current strategy consists of buying unlisted funds at discounts to today's valuation. This does not mean a discount to a theoretical internal valuation, rather, this is a discount to the stated monthly / quarterly valuation provided by the fund manager that is a sum of the underlying investments at today's market value. The average price AIQ has paid in the last three years has been 43% on the dollar of this value. In other words, if the fund that AIQ purchased at that price has listed stocks in its portfolio, we are gaining exposure at 43% of its market price. To make a return, we don't need its price to increase – we potentially can make a solid return even if the underlying position goes down in value.
- While other funds tout similar "discount capture" concepts, they tend to be limited to buying securities they can access in the listed market – being other exchange-listed funds or investment companies.
    - The listed market for these vehicles is a very small fraction of the overall fund market. As of August 2021, there are only 101 listed investment companies trading on the ASX (Source: ASX Website). By contrast, there are thousands of unlisted funds that are acquired outside a formal exchange each year;
    - The pricing dynamic is different and more efficient in the listed fund market - that can mean lower returns for buyers. Sellers are more easily able to access a broader universe of buyers (who aren't inhibited by access to information or investor qualification requirements) that are centrally located on one platform (the exchange). By contrast, in AIQ's target market within unlisted markets, sellers must transact directly with a scarce pool of bidders that are both approved to buy and have the required information to be able to bid. While AIQ is open to acquiring listed fund interests, Warana believes there is a more persistent and compelling risk / return dynamic in the unlisted market.
- AIQ's smaller size relative to other listed funds allows it to take advantage of positions that are less meaningful for sellers which may further enhance the market inefficiency and increase returns. Selling a large dollar position at a discount to net asset value is typically a heavier consideration for the seller as it could lead to significant absolute losses. Smaller positions can often be a nuisance and have lesser portfolio impact if sold – sellers often seek execution certainty, simplicity and speed when choosing to exit.
- The tax position of the Trust is also notable. Many of AIQ's investors have been investors since the Trust was managed by other parties and its assets were over $1bn. Unfortunately, the portfolio lost over $400m as a result of the 2008 financial crisis and the goal of Warana, when it became the new manager in 2018, was to grow the Trust to utilise as much of these losses as possible. The Trust has significant carried forward tax losses that, subject to certain restrictions, can potentially be used to offset investment gains. This means that if the underlying assets perform as expected, we anticipate that AIQ should not generate meaningful taxable income, allowing gains to be compounded. Please refer to disclaimers on page 5.

- The tax position and performance of the Trust allows it to pay a 5% of NTA distribution[1] (paid semi-annually) that has historically been classified as a return of capital and thus tax-deferred. The Trust targets investments with a 15% gross rate of return which is intended to fully cover the distribution.

Investing in AIQ gives our unitholders exposure to an attractive and niche investment market where Warana believes:

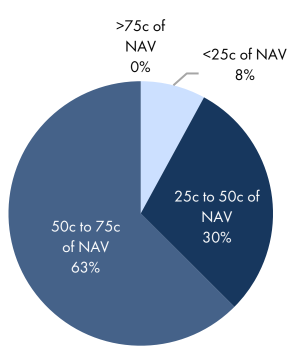
- it can sustainably target investments with return profiles higher than 15%;
- the entry discount available in the secondary market provides a margin of safety that strengthens the risk / return dynamic;
- AIQ's potential ability to use tax losses could further enhance unitholder returns and provide a tax-efficient yield.

Current state of the secondary market:

AIQ operates in secondary markets that do not have formal exchanges or listed platforms that allow for buyers and sellers to seamlessly meet and interact with each other. Participation in secondary markets generally involves a direct relationship between buyer and seller, sometimes with the help of a 'matchmaking' broker. In contrast to primary markets, transactions involve individually negotiated contracts which often make them more complicated than listed transactions. They also have longer execution timelines, introducing additional settlement and credit risk. This dynamic is an excellent platform for AIQ – it limits the buyer universe and gives experienced players like Warana a significant competitive advantage.

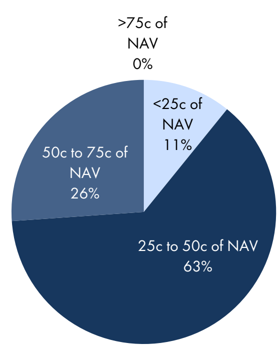
In the first half of 2021, Warana bid on over US$500m of potential acquisition opportunities. This amount represents only opportunities we have bid on – the overall market is much larger. It is rare for Warana to bid higher than 75% of the current net asset value and we tend to pass on situations where we feel discounts are insufficient. Our average price of purchased transactions in the first half of 2021 was 48% of the current net asset value.[2] The below charts highlight the distributions (as a % of net asset value) of price on situations we bid on, and situations we won. Because we are bidding significant discounts to the net asset value, sellers will often decide to hold rather than sell resulting in a success rate on bids of less than 20%.

Price distribution by Bid – 1H 2021



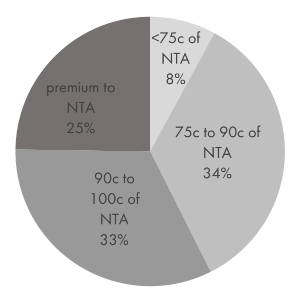
(Source: Warana data)

Price distribution by Winning Bid – 1H 2021



(Source: Warana data)

ASX listed fund price / discount dispersion as at August 2021



(Source: ASX)

[1] Not a forecast. Return is not guaranteed

[2] There is no guarantee that AIQ will be able to achieve this average discount in the future

Warana sources supply via a variety of channels including its network of fund managers (including those we are currently invested with), intermediaries/brokers, and past selling counterparties. These relationships are crucial to our business and the ability to establish and maintain them is a barrier for new players to enter the market. The Warana partners have been involved in this market for 12 years, have executed over 500 transactions in over 400 different funds and have established the firm as a linchpin in the space. As a result, the majority of the supply is inbound and generated directly from the networks and relationships that Warana has cultivated over the past decade. Warana is among the top handful of active players, we believe we have established a reputation as a strong and reliable counterparty for sellers. We have dedicated a team of resources to streamline the transfer process involved with each secondary market transaction. This process can be complex and requires approval from the fund manager. Many funds restrict transfers but Warana is a known, proven counterparty with strong industry contacts.

Primary fund investments:

We currently believe that the opportunity set in the secondary market, in general, is superior to investing in a new fund at 100 cents in the dollar. The entry discount afforded in the secondary market provides the fund with downside protection as we don't believe this exists to the same extent in other markets. With that being said, we do actively consider new fund investments and on occasion make primary investments.

For example, AIQ has exposure to a real estate fund that is managed by King Street Capital Management ("King Street"). We have invested with King Street for over 10 years, largely via opportunities in the secondary market and the real estate investments we have had exposure to have been among our best performing assets. As a result, when King Street began offering that strategy in a dedicated new fund, we made a modest investment on behalf of the Trust.

For primary investments, we feel the opportunity needs to be compelling enough and stack up favourably against opportunities available in the secondary market. We would not pursue primaries unless we had conviction that our return hurdle of 15%+ IRRs would be met. Each investment, whether primary or secondary is vetted based on its own merits. We do not intend to invest in primary funds just to deploy cash to gain market exposure. We expect to be looking at smaller, more niche opportunities within this space going forward.

Direct investments:

The AIQ mandate carves out a portion of its allocation for direct investments. Similar to new investments in funds in the primary market, the risk / return of these types of opportunities needs to be compelling.

AIQ's recent direct investing included the follow activities:

1. In the peak months of Covid-related uncertainty in 2020, we noted large discounts to NTA opened on a number of listed funds. We normally don't see the risk / return opportunity in the listed and unlisted markets line up. We took advantage through the acquisition of 3 different listed vehicles where we were able to return 9% over a 6-month period. We sold all of these positions as we saw prices normalise;
2. We invested in Thinksmart Limited ("Thinksmart"), an Australian company listed in the UK. While Thinksmart does have some operations, we considered it more as a holding / investment company that owned a look-through 6.5% stake in Clearpay Finance Limited ("Clearpay"), which is Afterpay Limited's ("Afterpay") UK business. Afterpay has a call option to buy the remaining Clearpay position and Thinksmart has a put option to sell it at a given future date in 2023. Thinksmart historically traded at a big discount to the value of its Clearpay stake which made it very similar to a secondary fund investment for us – assessing discount and catalysts for closure of the discount. While the position traded up naturally during our hold period in line with the underlying business performance, it has significantly spiked following Square Inc's announcement of its acquisition of Afterpay which could trigger the buyback of the Thinksmart position. At the time of writing, Thinksmart is trading at GBP 106.00 per share which is over 4.0x return on our cost. We recently sold a third of our position to recoup our entire cost base;

3. AIQ made a small investment ($350,000 of cost) in a Ukrainian telecommunications company. The acquisition was a part of a broader co-investment by Warana and at the time of purchase represented an entry valuation of 1.8x EBITDA. The company is one of the largest TV and internet providers in the country, making over US$20m of EBITDA and growing at a steady rate. It was an unusual trade for Warana as it is atypical for us to take on the type of geo-political risk associated with the investment. We determined that the entry price, potential upside and strong group of other investors warranted a modest investment. The strong cash flow generation of the business relative to the entry valuation made us feel we had good downside protection. Unfortunately, soon after investment a number of the geo-political events occurred which hampered any chance of receiving an exit multiple warranted by company performance. We sold our position at a little higher than cost to close out the risk.

We continue to see further opportunities to review but remain disciplined and selective. We generally seek a higher than 20% target return on equity investments and higher than 10% on secured debt deals.[1]

<u>Cash and foreign exchange management:</u>

The longer-term plan is to have AIQ fully invested and not to have latent cash that is not generating return for investments, particularly with current interest rates so low. In periods of high volatility or where we aren't excited by the risk / return opportunity we may maintain higher cash balances to insulate the portfolio. We are also mindful that we intend to pay an approximate 5% distribution of the Trust's NTA (paid semi-annually).[1] Additionally, we do not intend to hedge the currency risk of the Trust.

The Trust has current net cash of approximately A$2.8m. We also expect the portfolio to generate at least a further A$5m over the next 12 months. This cash is currently allocated to the Warana 2021 Fund to continue investing in absolute return funds via the secondary market.

The vast majority of AIQ's investments are in USD and other non-AUD currencies. The general plan for the Trust will be to hold cash in USD to give investors a non-AUD exposure.

<u>Outlook:</u>

We recognise that AIQ is a small vehicle and has limited liquidity as it is largely owned by a number of long-term supporters of the Trust and Warana. The Trust needs to grow to be more relevant and achieve further economies of scale.

The current strategic plan for the Trust is to:

- Continue to deploy capital into the secondary market where we believe there is a very compelling risk / return profile and ability to target greater than 15% pa returns;
- Continue to consider strong direct investment opportunities but remain very selective and try to avoid one-way market exposure bets;
- Continue to provide a 5% of NTA annualised cash yield to investors in the form of a tax-effective distribution, paid semi-annually;[1]
- Manage costs prudently, given the small scale of AIQ; and
- Seek to improve the scale of the Trust, the trading liquidity and to reward existing investors. We are considering initiatives such as rights and option issues to further align our investor base and drive scale.

We consider AIQ to be well-positioned to deliver on its strategic plan and we remain motivated to continue to drive positive returns for investors.

Footnotes & Disclaimers:

[1] Not a forecast. Return is not guaranteed
[2] There is no guarantee that AIQ will be able to achieve this average discount in the future

Figures presented in this discussion are unaudited and cover the period up to 31 July 2021.

As at the end of the 2020 tax year, the Trust has in excess of A$400m in accumulated tax losses and in excess of A$20m in accumulated capital losses. Under certain circumstances and provided relevant legislative conditions are satisfied, these losses may be able to be applied against future taxable income to reduce the amount of taxable income and therefore the amount of any income distribution.

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AIQ is exposed to foreign exchange risk as a result of investments in financial instruments denominated in foreign currencies, particularly US dollars. This risk is implicit in the value of portfolio securities denominated in a foreign currency and transactional exposure arising from the purchase or sale of securities. The Investment Manager and Responsible Entity have not hedged AIQ's exposure to the US dollar.

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