Tuesday, 3 April 2018

Rupa Kapadia
ASX Compliance Pty Ltd
Level 6, Exchange Centre
20 Bridge Street
SYDNEY NSW 2000

Response to foreign shorter opinion piece

Dear Rupa,

On Wednesday 28 March 2018 Blue Sky Alternative Investments Limited ('Blue Sky', ASX: BLA) became aware of an opinion ('Opinion') published by a foreign short seller ('Glaucus'). This letter provides a response to the Opinion.

Blue Sky has carefully reviewed the Opinion, and considers that the Opinion:

- includes a series of basic factual errors concerning Blue Sky's business and investments;
- includes analysis of the financial position and performance of Blue Sky and its investments that is fundamentally flawed and inconsistent with market practice;
- ignores clear, specific and repeated public disclosures made by Blue Sky;
- ignores, or neglects to check, readily accessible public information which categorically disproves many of its fundamental assertions; and
- is materially misleading.

The Opinion does not identify any information which previously has not been disclosed and which the Board believes a reasonable person would expect to have a material effect on the price or value of Blue Sky's securities. Nor does it identify any errors in the information that has been previously disclosed by Blue Sky. The Board considers that Blue Sky is, and has been at all times, in full compliance with its disclosure obligations.

Blue Sky was concerned that the Opinion had the potential to create a false market in Blue Sky's securities. Consequently, Blue Sky requested a trading halt under ASX Listing Rule 17.1 on Wednesday 28 March. Blue Sky remains concerned that its securities may have been traded in a false market on Wednesday 28 March, in breach of the ASX Listing Rules. Blue Sky is also concerned that Glaucus and any associates who engaged in the notable increase in short selling in recent months, may have manipulated the market in breach of the Corporations Act. Accordingly, at 7:30am (AEST), this morning Blue Sky formally invited ASIC to investigate Glaucus and the short selling of Blue Sky securities in recent months. Blue Sky has offered full assistance to ASIC and complete access to all relevant materials relating to all matters referred to in the Opinion, including Blue Sky's fee-earning AUM and investment performance. In addition, at 7:30am (AEST) this morning Blue Sky's US lawyers served Glaucus with a preservation notice, requiring it to preserve all relevant documents and communications whilst Blue Sky evaluates possible future legal steps.

Blue Sky is a fund manager with fiduciary obligations to its fund investors. Because of the nature of Blue Sky's investments, these fiduciary obligations extend to keeping confidential certain investment information, such as the assets in which it invests, the value of investments and the returns it generates. Blue Sky fulfils these obligations to its investors, including by: not disclosing asset carrying values; only disclosing fee-earning assets under management ('fee-earning AUM') in aggregate; and only disclosing investment returns by asset class since inception. For that reason, the information that is required to establish or substantiate the Opinion is not publicly available. Consequently, the Opinion seeks to construct a hypothesis relying on incomplete and inaccurate information.

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Individual investment information is carefully assessed by the Board and regularly reviewed and tested (on a confidential basis) by relevant third parties in connection with the preparation and release of Blue Sky's financial statements and the aggregated information referred to above. The parties involved in this process are: first, the independent valuers of assets managed by Blue Sky, including KPMG, Colliers International, CBRE, JLL, Elders Rural Services, Savills and Herron Todd White; secondly Blue Sky's auditors, EY; and finally, institutional investors conducting due diligence before awarding Blue Sky investment mandates. Each has complete access to all information required to form a view on matters relevant to them, such as the amount of Blue Sky's fee-earning AUM, the value of its assets and its investment track record.

Blue Sky has attracted 6 Australian and 14 offshore institutions (representing more than 40% of Blue Sky's fee-earning AUM) to invest in funds and mandates across all four of Blue Sky's asset classes. Those institutions include First State Super, Goldman Sachs, the South Australian Government, SC Capital, Canada's Public Service Pension Investment Board, LGIASuper and Equinox Funds. In each case the institutions and their advisers undertook detailed due diligence including reviewing Blue Sky's investment track record.

Having considered each and every point in the Opinion, the Board confirms its previous releases to the Australian Securities Exchange ('ASX') that:

- Blue Sky's fee-earning AUM was $3.9 billion at 31 December 2017 and exceeded $4.0b on 9 March 2018; and
- Blue Sky has delivered its fund investors equity weighted returns since inception of 15.0% per annum (pre-tax and net of all fees) through to 31 December 2017.[1]

For the reasons given in Appendix 1, Blue Sky believes that the assertions made in the Opinion are incorrect, fundamentally flawed and materially misleading; and that these flaws call into question the research methods and accuracy of all claims throughout the Opinion.

Yours sincerely,

John Kain
Chairman
Blue Sky Alternative Investments Limited

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[1] Past performance is not a reliable indicator of future performance. For further details, please refer to the 1H FY18 Results Presentation released to the ASX on 19 February 2018.

Appendix 1: Analysis of Opinion

1. Opinion 1: Fee-earning AUM

The Opinion asserts that fee-earning AUM is overstated, based upon five claims. Each claim is incorrect.

Claim 1.1: Blue Sky's fee-earning AUM is estimated at most to be $1.5 billion

This is incorrect.

The Opinion's 'bottom up' calculation of fee-earning AUM, is based upon a series of incomplete and inaccurate assumptions explained in this Appendix 1, including:

- there are numerous assets which Blue Sky manages (in particular for institutional investors) which are excluded from the Opinion's calculation because they have not been identified or because of the incorrect claim that they are advisory and not asset management mandates;
- there are numerous joint venture assets which Blue Sky manages (such as for Goldman Sachs and SC Capital) which are incorrectly excluded from the Opinion's calculation; and
- the Opinion seeks to calculate fee-earning AUM in a manner which is inconsistent with the practice of the Australian market (see Appendix 2). This practice is applied by Blue Sky.

As explained in the covering letter, having considered the Opinion, the Board confirms its previous releases to the ASX that Blue Sky's fee-earning AUM was $3.9 billion at 31 December 2017 and exceeded $4.0b on 9 March 2018. Further detail on the breakdown of Blue Sky's fee-earning AUM is shown in Appendix 3.

Claim 1.2: Inclusion of debt in fee-earning AUM defies common reporting practice for Australian real estate fund managers

This is incorrect.

In defining fee-earning AUM, Blue Sky has had regard to the common Australian industry definition of AUM (gross realisable value, market value or fair value) adjusted for any funds that are not fee-earning. This approach has been repeatedly disclosed by Blue Sky including most recently in the investor presentation released on 5 March 2018, which states AUM for Blue Sky Private Real Estate Funds is the gross realisable value of the fund.

It is common reporting practice for Australian property fund managers to report the gross realisable value (or 'fair value' or 'market value') of an asset in a property fund when reporting AUM. Examples of a number of listed Australian fund managers and the AUM calculations used by these managers are in Appendix 2. The information in Appendix 2 is disclosed on the websites and/or the ASX filings of those managers.

The Opinion cites (unlisted) Rural Funds Management (RFM) as an example of an Australian manager which excludes debt from its AUM calculation. This is incorrect and misrepresents the practices of RFM. RFM includes the total assets of each of the funds that it manages in its AUM calculation, including both debt and equity. These facts are disclosed on RFM's website. These records are public and are disclosed on RFM's website. The Opinion deliberately misrepresents the practices of RFM.

In addition to this the Opinion misleadingly presents Magellan Financial as a peer of Blue Sky ignoring the fact that Magellan Financial is a listed equities manager and does not invest in the same asset classes as Blue Sky.

Claim 1.3: Blue Sky does not earn management fees from investments with joint venture partners

This is incorrect.

In Blue Sky's domestic real estate joint ventures, Blue Sky manages the funds in which joint venture partners Goldman Sachs and SC Capital have invested. Blue Sky earns fees on assets managed for Goldman Sachs and SC Capital.

Claim 1.4: Blue Sky wrongly includes advisory mandates as management mandates in its fee-earning AUM

This is incorrect.

Blue Sky manages a number of institutional mandates (including the Real Assets mandate from First State Super) which are described as advisory mandates. Each of these mandates, however described, is a mandate to manage assets upon which Blue Sky earns fees on an ongoing basis.

Claim 1.5: Blue Sky calculates fee-earning AUM based upon re-valuations of its portfolio

This is correct for open-ended funds (the water fund, and hedge funds), certain institutional mandates and one wholesale closed-ended fund. These funds account for less than one quarter of total fee earning AUM. Otherwise, it is incorrect: for all other institutional mandates, and all wholesale closed-ended funds, fee-earning AUM does not change with re-valuations of respective portfolios.

2. Opinion 2: Investment Performance

The Opinion asserts that Blue Sky overstates its investment performance, based on five claims. Each claim is incorrect.

Claim 2.1: External valuations cannot be relied upon

This is incorrect.

Blue Sky's valuation process has been explained in detail in various investor presentations released to the ASX. A copy of the relevant pages of those presentations is in Appendix 4. The valuation in each asset class is separately reviewed by top-tier valuers. They include KPMG, Colliers International, CBRE, JLL, Elders Rural Services, Savills and Herron Todd White, together with five independent directors of two ASX listed companies (ASX:BLA and ASX:BAF).

Claim 2.2: Increases in asset values increase management fees

This is true of open-ended funds (the water fund and hedge funds), certain institutional mandates and one wholesale closed-ended fund. These funds account for less than a quarter of total fee earning AUM. Otherwise, it is incorrect: for all other institutional mandates, and wholesale closed-ended funds, management fees are unaffected by changes in asset values.

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Claim 2.3: An increase in receivables is due to a deterioration in investment performance

This is incorrect.

Blue Sky accrues performance fees and these accruals are recognised as receivables. An increase in the fee-earning AUM and/or positive investment performance will typically cause an increase in receivables. Blue Sky's receivable to revenue ratio and receivable to fee-earning AUM ratio is comparable to the global peers to which the Opinion seeks to compare Blue Sky.

	Blue Sky	Blue Sky	Blackstone	Carlyle	KKR	Ares	Apollo
	Underlying (AUD)	*Statutory (AUD)*	*(USD)*	*(USD)*	*(USD)*	*(USD)*	*(USD)*
Reporting Date	*31-Dec-17*	*31-Dec-17*	*31-Dec-17*	*31-Dec-17*	*31-Dec-17*	*31-Dec-17*	*31-Dec-17*
Fee-earning AUM ($B)	3.9	3.9	335.3	124.6	117.4	78.2	169.0
Receivables* ($B)	0.1	0.1	8.2	4.0	4.6	1.3	2.1
Receivables* as a % of FEAUM	2.7%	2.5%	2.5%	3.2%	3.9%	1.7%	1.3%
Receivables* as a % of Revenue	104.0%	113.3%	115.8%	108.2%	89.9%	79.9%	68.5%

*Receivables include carried interests and accrued performance fees

Claim 2.4: Investment track record is calculated as an average of returns

This is incorrect.

Blue Sky has repeatedly stated that its returns to fund investors are equity weighted returns since inception. They are not equally weighted average returns. Consequently, contrary to the Opinion's assertions, the performance of a small investment in Beach Burrito Company (on this equity weighted basis) has had no material impact on Blue Sky's reported investor returns.

Claim 2.5: The Opinion's analysis of seven companies verifies its thesis on valuations and performance

This is incorrect.

It is inaccurate to extrapolate performance of seven selected assets across a portfolio of eighty funds. Further, the purported financial and valuation analysis of each of the seven portfolio companies in the Opinion are grossly inaccurate. Blue Sky is bound by fiduciary and confidentiality obligations in respect of its funds and cannot comment on all specific allegations relating to these investments.

However, to demonstrate the inherent flaws and inaccuracies in the purported analysis, Blue Sky provides the following examples of those factual inaccuracies:

- Foundation Early Learning does not have '…a net debt to EBITDA ratio of 10.8x.' This ratio is grossly overstated. This business is banked by one of Australia's four major banks and is in compliance with all of its lending covenants, including its debt to EBITDA covenant.
- The claim that Blue Sky's carrying valuation of Beach Burrito Company is grossly inaccurate. The carrying value is less than $20 million (for 100% of the equity); that is less than one third of the $62 million asserted in the Opinion.
- The Opinion asserts that Vinomofo should not have been revalued in December 2016 because the business missed its investment case. Vinomofo grew materially in that financial year (including overseas), with its valuation reviewed by KPMG as part of our standard processes.

- Blue Sky, along with other VC investors, participated in two separate funding rounds for THR1VE**.** The Opinion asserts that the follow-on round was both priced at a 3.2x revenue multiple and set at Blue Sky's sole discretion. Both of these allegations are incorrect. The pricing of both funding rounds was fixed after negotiations between up to eight unrelated investors who participated in the funding of THR1VE. The price was not set at Blue Sky's sole discretion. Furthermore the follow on round was priced at a pre-money valuation of less than one third of the revenue multiple claimed in the Opinion.
- The Opinion asserts that the exit of Viking Rentals to Bayfront Capital Management was – in their words – 'deeply suspicious'. The Opinion suggests that '…perhaps Blue Sky or investors affiliated with Blue Sky were really behind Bayfront.' This assertion is incorrect, and on the same day that the Opinion was published, the Australian media were able to contact the director of Bayfront who confirmed that Bayfront '…has no relation to, or association with Blue Sky whatsoever.'
- The assertion that new investors 'bought out' previous investors in Lenard's and Viking Rentals is incorrect. Funds managed by Blue Sky first invested in Lenard's and Viking Rentals in 2007 and 2009 respectively. These assets (and the investors that had invested in their respective funds), became the seed assets (and investors) in a pooled private equity fund (EC2010) at its inception. New investors contributed additional capital to this fund, with none of this additional capital used to buy out prior investors.
- Blue Sky's investment in HeyLets was made through a US dollar convertible note instrument. The underlying US dollar HeyLets investment was never revalued and was retained at the original investment value until written off to $0 in June 2017. The return reported by the Opinion was merely the result of movements in foreign currency. HeyLets was one of five assets in the VC2012 Fund that also included Hatchtech and Pet Circle. Both Hatchtech and Pet Circle were awarded AVCAL's 'Best Early Stage Investment' in 2016 and 2017 respectively.

3. Opinion 3: Fee structure

The Opinion asserts that Blue Sky's fee structure is unsustainable based upon three claims. Each claim is incorrect.

Claim 3.1: Blue Sky charges up to 17% management fees versus an industry standard of up to 2%

This is incorrect.

For its closed ended funds, Blue Sky typically charges a mix of fees, some of which (such as due diligence fees) are charged at the start of a fund, some of which (such as annual investment management fees) are charged over the life of a fund, and some of which (such as performance fees) are paid at the conclusion of a fund.

The Opinion misrepresents Blue Sky's fee structure by aggregating management fees over the life of the fund (including fees that are paid to third parties). It then compares this aggregated fee to an annual management fee apparently charged by other alternative asset managers.

There are a number of other structural differences between Blue Sky's fee structures and those of other alternative asset managers which are advantageous to fund investors, but which the Opinion neglects to consider, including the fact that Blue Sky typically charges fees on invested capital not committed capital.

The Opinion's comparison is therefore misleading.

Claim 3.2: Blue Sky annual management fees are paid to Blue Sky in advance

This is incorrect.

Each of Blue Sky's closed ended, multi-year funds typically raise sufficient working capital to allow these funds to meet their anticipated obligations (including the obligation to pay any annual management fees) over the life of each fund. That working capital is retained by each fund, in that fund's bank accounts. Over the life of a fund, that money is drawn upon to pay the fund's expenses (such as any annual management fees) as they fall due.

Management fees for Blue Sky's open-ended funds are paid when they fall due out of the cash or realised liquid assets within each fund.

Blue Sky does not record future years' annual management fees (from either closed-ended or open-ended funds) in its reported income. Nor does Blue Sky receive cash for future years' annual management fees.

Claim 3.3: The decline in management fees as a percentage of fee-earning AUM confirms that the fee structure is unsustainable

This is incorrect.

Blue Sky's management fees as a percentage of fee-earning AUM (~1%) is in line with those global managers to which the Opinion seeks to compare Blue Sky.

Blue Sky's management fees as a percentage of fee-earning AUM have reduced in recent years, principally due to the growth in institutional capital and the growth in Cove Property Group and Student Quarters.

Blue Sky sources capital from three sources: institutional, wholesale and retail (see Appendix 3). The fee structures for each group are different, with fees paid by institutions (when expressed as a percentage of AUM) typically being lower given the far larger scale of their investments. Lower headline rates charged to institutions (on larger capital bases), coupled with an increase in institutional fee-earning AUM (9% of fee-earning AUM at 30 June 2015 to 40% at 31 December 2017) reduces the proportion of management fees as a percentage of fee-earning AUM.

Blue Sky includes 38% of Cove Property Group's and 60% of Student Quarters' fee-earning AUM in Blue Sky's fee-earning AUM. This reflects Blue Sky's equity ownership of each of these respective businesses. In accordance with Australian Accounting Standards (and specifically *AASB 128 'Investments in Associates and Joint Ventures'*), the management fees earned by Cove Property Group and Student Quarters are reported in the 'share of profit of associates' line of Blue Sky's income statement and not the management fees line of Blue Sky's income statement. Therefore, the growth in Cove Property Group and Student Quarters fee-earning AUM (with their respective management fees being reported in 'share of profit of associates' rather than 'management fees') also contributes to the decline in management fees as a percentage of fee-earning AUM.

Opinion 4: Sale of shares by former Managing Director

The Opinion asserts that Mark Sowerby, Blue Sky's founder and Managing Director from 2006 – 2016, sold shares in anticipation of a decline in Blue Sky's share price.

This is incorrect.

Mark Sowerby retired from Blue Sky following release of the FY2016 results. During the month in which he announced his decision the share price had reached $8.99.

Mark then conducted a week-long roadshow during which he explained the reasons for his retirement. They were:

- He had been running the company for ten years;
- His family, and particularly his boys, had reached an age where he needed to be around, and this wasn't possible as Managing Director of Blue Sky; and
- Blue Sky was in excellent shape and the team were ready to take over.

Mark sold 3.365 million (of his 8.365 million) shares to a small number of mostly institutional investors at $8.00 per share. He did this whilst a Director and after announcing his retirement and allowing time between his announcement and the sale. This provided financial security for his family and the freedom to then pursue other social good endeavours (including in philanthropy and public service).

Mark retained 5.0 million shares. He has since sold an additional 0.6 million shares.

Mark retains 4.4 million shares, representing the majority of his personal wealth. He is Blue Sky's largest individual shareholder (and third largest shareholder overall) and remains committed to the company.

Appendix 2: AUM calculations of ASX property managers

Company	Ticker	Reported AUM	Approach to AUM	Example statement	Source document
Charter Hall	ASX: CHC	$21.9 billion	**FUM:** fair value of real estate assets	*"Funds Under Management (FUM) of $21.9 billion across a portfolio comprising 336 properties"*	2017 Annual Report (pg. 3, 28)
Dexus	ASX: DXS	$26.5 billion	Fair market value of property assets owned and under management on behalf of third parties	*"Dexus is one of Australia's leading real estate groups, proudly managing a high quality Australia property portfolio valued at $26.5 billion."* *"We…directly own $13.1 billion of office and industrial properties. We manage a further $13.4 billion of office, retail, industrial and healthcare properties for third party clients."*	Company Website ('Our Business')
Goodman Group	ASX: GMG	$34.6 billion	**AUM:** total market value of property assets owned or under management	*"AUM": Total value of properties directly held or under management* *"$34.6bn total assets under management"*	2017 Annual Report (pg. 187)
GPT Group	ASX: GPT	$21.5 billion	Total market value of property assets	*"The GPT Group is one of Australia's largest diversified property groups and a top 50 ASX listed company by market capitalisation. GPT owns and manages a $21.5 billion portfolio of offices, logistics, business parks and prime shopping centres across Australia."*	2017 Annual Report (pg. 3)
Macquarie Group Limited	ASX: MQG	$474 billion	**AUM:** Proportional ownership interest in the underlying assets of funds and mandated assets	*"AUM is calculated as the proportional ownership interest in the underlying assets of funds and mandated assets that Macquarie actively manages or advises, adjusted to exclude cross holdings in funds and reflect Macquarie's proportional ownership interest of the fund manager."*	HY18 Interim Report (pg. 83, 84)
Mirvac Limited	ASX: MGR	$17.0 billion	**AUM:** total market value of office, industrial, retail and residential real estate	*"Mirvac owns and manages assets across the office, retail and industrial sectors in its investment portfolio, and currently has over $17bn of assets under management."*	2017 Annual Report (pg. 1)

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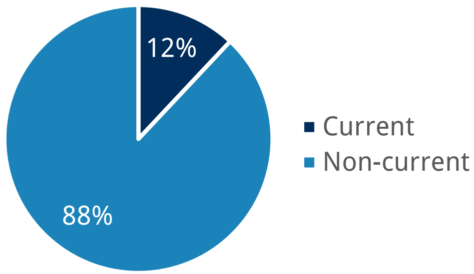
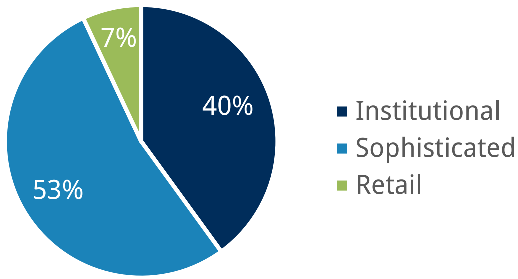
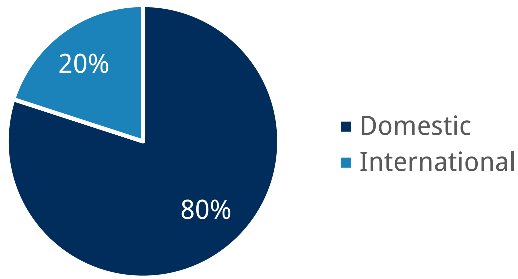
Appendix 3: Fee Earning AUM (at 31 December 2017)

Fee-earning AUM: Current vs. non-current	Fee-earning AUM: By investor type	Fee-earning AUM: By location
		
• 88% of fee-earning AUM ($3.4b) is 'non-current': it includes (i) closed-ended funds and institutional mandates not anticipated to be realised in next twelve months; and (ii) BAF • Breakdown is relevant as 'non-current' fee earning AUM from 'sticky' closed ended funds is likely to be retained beyond twelve months; 'current' fee-earning AUM may not	• Blue Sky's fee-earning AUM comes from three segments: institutional, sophisticated and retail • Breakdown is relevant as fee structures for each group are different, with fees paid by institutions (when expressed as a percentage of AUM) typically being lower given the far larger scale of their investments.	• 80% of Blue Sky's fee-earning AUM comes from domestic investors • Mix of domestically and internationally sourced fee-earning AUM relatively stable over time (21% international at 30 June 2016) • Breakdown is relevant to provide an indication of locations from which capital is sourced

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Appendix 4: Valuation process

Valuations: Our process incorporates independent expert and audit sign off across all asset classes

BlueSky Alternative Thinking

Valuation Process

Independence – Independent valuation experts used across all asset classes

Methodology and inputs – Valuation methodology and all key valuation inputs (e.g. discount rates, earnings multiples) are reviewed by independent experts

Institutional investor review – The valuations of our investments are reviewed by our institutional investors (for those funds that they have invested in)

Audit review – The valuations of our investments are reviewed every reporting period by Ernst & Young in their capacity as Blue Sky's auditor

Board review and sign off – Valuations are reviewed and signed off by:

- The directors of the Audit Committee (all independent directors);
- The board of Blue Sky; and
- Where relevant, the Audit and Risk Committee and Board of BAF

Frequency – Independent review undertaken at least annually for all assets that may have a material impact on Blue Sky's financial results (and more frequently where appropriate e.g. Water Fund, hedge funds)

Market standard – The process is based on the approach used by other leading global alternative asset managers

Independent Valuation Experts

Private Equity – KPMG

Private Real Estate – JLL, savills, KPMG, HERRON TODD WHITE

Real Assets – Colliers International, CBRE, KPMG

Hedge Funds – nab

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Valuations: Blue Sky Water Fund example

Market prices *Monthly*	Independent market prices determined by Colliers based on recent trades of similar or equivalent assets in the water market and with reference to public data	
Water asset holdings *Monthly*	Australian Executor Trustees is the independent custodian and holds all Water Fund assets in its name. It maintains the register of water assets held by the Fund and provides monthly holding statements of water assets held by the Fund	
Unit valuation *Monthly*	The independent prices and independent holding statements are then used to calculate the value of units in the Water Fund on a monthly basis	
Institutional review *Monthly*	Institutional clients review the monthly report issued by Blue Sky, which contains a detailed description of valuation movements and performance of the portfolio	
Fund audit *Annually*	The Water Fund is audited annually by Deloitte	
BLA and BAF audit / review *Every six months*	Ernst & Young review the Water Fund as part of the half year review and full year audit for BLA and BAF	
Audit committee sign off *Every six months*	The Audit Committee of BLA (all independent directors) and Audit & Risk Committee of BAF (majority independent directors) sign off on the Water Fund valuation every six months	
BLA & BAF Board sign off *Every six months*	Directors of the boards of BLA and BAF sign off on the Water Fund valuation as part of half year and full year reporting	

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