BlueSky Alternative Thinking

Thursday 6 October 2016

To our Blue Sky investors, shareholders and supporters,

As I approach the end of my first 'official' week as Managing Director, I thought I would take the opportunity to write to you and provide an update on our progress as well as outline my plans for our business.

FY16 was another good year for us. Across all of the key metrics our business grew at approximately 50%. Fee earning assets under management ('AUM') was up 55% (to $2.1 billion at 30 June 2016), income was up 44% and NPAT was up 57%. EBITDA margins increased from 36.5% to 39.0% and will continue to move towards 50% as we scale. We converted approximately 1% of our average AUM to NPAT and this will also continue as we scale.

Most pleasingly, investor returns improved over the year and our ten year track record – which we had formally reviewed by Ernst and Young – now stands at 16.7% p.a. (net of fees, since inception).

Our growth has accelerated in the first quarter of FY17. Fee earning AUM was up to $2.4 billion at 30 September 2016 after making a couple of realisations in the first quarter. This growth reflects strong deal flow across the business and increasing engagement with institutional and sophisticated investors, both domestically and offshore. With this acceleration, I anticipate we will be well through $3.0 billion in fee earning AUM by 30 June 2017.

In Private Equity, our team remains focused on investing in 'the essentials': businesses that sell products/services that people need rather than things they want. We have therefore targeted investments in areas such as healthcare, childcare, information technology and food. Focusing on these areas has seen the portfolio continue to perform well despite the overall low growth environment. As an example, in FY15 our team invested in a pharmacy business called Hospital Pharmacy Services ('HPS') with the backing of Partners Group – the world's largest investor in private equity. HPS continues to grow rapidly with revenues up more than 50% since we invested, the business is winning market share and I expect will be in a position to exit in the near future. This follows the sale of Readify to Telstra in June 2016 which generated a net IRR to investors of 23% and that sold at a 10% premium to the value at which we had held it in our accounts.

Our Venture Capital team follows a similar strategy to our Private Equity team (albeit focused on earlier stage businesses) and has generated similar levels of success. As a recent example, this team was part of a consortium of investors in Hatchtech, a business that has created a leading treatment for head lice, that won this year's AVCAL award for Best Early Stage investment.

Our Private Real Estate business has invested in three areas. Historically, this team had focused on residential real estate developments, an area that we accelerated our deployment of capital into back in FY12. We are still completing a handful of more recent investments in this area, most of which will be finished this year including our latest development which finished last week. This building was sold out to local buyers and we recorded our fastest ever settlements in the ten year history of our business (including paying off all bank debt on the first day of settlements). We have generated a net return on equity of 45% for investors in this fund and will exit a further two residential investments in the next two months (with net returns on equity to investors in both of these funds in excess of 50%).

The exit of Readify and the completion of this latest development bring our total number of realisations across Private Equity and Private Real Estate to twenty-nine. Pleasingly, our realised track record is superior to our overall investment track record (PE/VC: 18.2% realised vs 17.7% overall; PRE: 18.5% realised vs. 16.3% overall).

Whilst we have done well in residential property historically, this is a sector that is no longer as attractive as it was. As a diversified alternative asset manager, one of the benefits of our model is that we can move into and out of sectors like this depending on the cycle. We are not beholden to investing in any particular sector or asset class. As a result, two years ago we pivoted this team to student accommodation, an asset class with long term structural tailwinds (there is a multi-decade trend of increasing numbers of international students), that is defensive (in every economic downturn over the last thirty years, student enrolments have gone up!), and that is asset backed and income generating. In Australia, it is an asset class that is also underpenetrated – we have 25% the number of beds per student as more advanced overseas markets such as the United Kingdom.

Unsurprisingly, Australia is now catching up and the sector has attracted a lot of interest lately. Fortunately, our team has a two year head start. In that period, we have secured seven sites totalling approximately 3,900 beds (with our first site already complete and occupied), we have acquired the leading independent manager of student accommodation (The Pad) and with the backing of Goldman Sachs we are able to continue to rapidly build our portfolio towards our target of 10,000 beds.

BLUE SKY ALTERNATIVE INVESTMENTS LIMITED

Post PO Box 15515, Brisbane QLD 4002
Phone +61 7 3270 7500
Fax +61 7 3270 7599
Email investorservices@blueskyfunds.com.au

HEAD OFFICE

Level 46
111 Eagle Street
Brisbane QLD 4000

ABN 73 136 866 236

blueskyfunds.com.au

The third part of our Private Real Estate business is retirement villages. We made our first investment in this sector last month backing two highly regarded operators in this market (Tim Russell and Mark Taylor, the former CEO and CFO of Retire Australia). This is a sector that has significant demographic tailwinds, has a chronic level of undersupply, and one that represents an enormous opportunity for us to scale into.

Our Real Assets team continues to perform exceptionally well and has carved out a leading reputation for investing in water entitlements and agriculture. Our water fund has doubled in value since inception in 2012 and is up 17.5% over the last twelve months. The dynamics that have driven the growth in water prices remain the same: there will be no more supply of water in the foreseeable future, but an ever increasing demand for Australian agricultural output driven by a growing world population and a massive Asian middle class. Recent rainfall in the Murray Darling Basin has had virtually no impact on the price of the perpetual rights we invest in, and we continue to deploy capital in this space with the backing of both domestic and international institutions, including one of Australia's largest superannuation funds (First State Super).

Our Hedge Fund team's investment returns have also been world class, and they were recognised by Barclay Hedge earlier this year as one of the Top 20 CTAs globally as well as winning the HFM Award last month for the Best Macro Fund in Asia. This team deserves to be managing significantly larger sums of money than they are, and to that end we now have a dedicated team member on the ground in New York raising capital for this team.

In the US, our business is now one of substance. We first opened our office in New York in 2013 to raise capital out of the US, a strategy that has proven successful. On the investment side, we completed our first private equity transaction in FY16 and I expect we will complete our second in the coming months. In addition, our joint venture with Cove Property Group (of which we own 38%) has purchased two assets in its first year in business, deploying over A$680m across these deals and backed by two blue chip US institutional investors. This figure will continue to grow as capital is deployed to reposition these assets and as Cove finds additional institutional grade property assets to invest in.

The collective investment performance across our business is starting to come through in the performance of our listed investment company, the Blue Sky Alternatives Access Fund (ASX: BAF). In FY16, our LIC delivered 9.4% growth in pre-tax NTA, a 23.6% total shareholder return and has just paid a 5 cents per share dividend. The fact our LIC has been trading at a consistent premium to NTA reflects the intrinsic value of this portfolio as well as the increasing demand for alternatives.

After ten years in business, we have built an exceptional platform. We have a ten year track record across four asset classes that is difficult to replicate. We have a balance sheet with net tangible assets in excess of $130m, cash in excess of $60m and virtually no debt. It is a balance sheet built to last. We have a high quality team with virtually zero turnover and one which is deeply invested in our funds and our company.

With this platform in place, it was obviously with a lot of excitement that I accepted the role of Managing Director. I have been with Blue Sky since 2010 and have worked closely with our founder – Mark Sowerby – and the Board since then. Under my leadership, the strategy of the business will remain the same: with the opportunities in front of our business there is simply no need to change. We need to keep our heads down, remain focused on finding investments that generate exceptional returns for our investors and that continue to attract domestic and offshore investors to our business. If we do those things, I see no reason why we won't grow to at least $5 billion in fee earning AUM in the next three years and $10 billion shortly thereafter.

We have two upcoming events where I intend to share further details of our growth plans and that I would encourage you to attend. The first is our annual general meeting which will be held in Brisbane on 18 November 2016. As our business has matured, we now have better visibility than ever over where our business is heading and I intend to provide earnings guidance for FY17 year at this meeting.

The second event is our annual investor conference which will be held on 30 November and 1 December 2016. This conference includes several world class speakers, presentations from all of our investment teams as well as an exhibition where you have the opportunity to meet all of our investee companies. It will provide you with an unparalleled insight into our business and our investments and last year attracted in excess of 1,300 people. Invitations will be mailed to investors and shareholders in the coming week and I would encourage you to RSVP promptly as spaces are limited. If you are not currently an investor or shareholder, you will find details of this event on our website (www.blueskyfunds.com.au).

These are exciting times for our business and I look forward to sharing more with you at these events.

Regards,

Robert Shand

BLUE SKY ALTERNATIVE INVESTMENTS LIMITED

Post PO Box 15515, Brisbane QLD 4002
Phone +61 7 3270 7500
Fax +61 7 3270 7599
Email investorservices@blueskyfunds.com.au

HEAD OFFICE

Level 46
111 Eagle Street
Brisbane QLD 4000

ABN 73 136 866 236

blueskyfunds.com.au