LAKEHOUSE SMALL COMPANIES FUND LETTER
31 DECEMBER 2017

Companies Held:	19
Cash Allocation:	12.8%
Top 5 Portfolio Holdings:	36.4%
Net Asset Value per Unit:	$1.3966 (ex 1.15 cent distribution)
Fund Net Asset Value:	$136.5 million (ex $1.1 million distribution)
Benchmark:	S&P/ASX Small Ordinaries Accumulation Index

Dear Lakehouse Investor,

The Lakehouse Small Companies Fund posted a strong finish to a busy year. A lot went right for the Fund during the month and, as we'll discuss in greater depth shortly, we exited 2 different positions at a profit. We're also pleased to note that the Fund has announced its first distribution of 1.15 cents per unit.

The Fund returned 7.1% net of fees and expenses in December compared to a 3.2% return for the benchmark. The Fund has now returned a net 30.2% in thus far in fiscal 2018 compared to 18.7% for the benchmark. Since inception in mid-November 2016, the Fund has returned a net 40.8% compared to 25.0% for the benchmark.

We are pleased with the Fund's recent performance, however, our team does not judge itself based on short-term results and neither should investors who embrace our long-term, high-conviction strategy. It's also worth remembering that, while small-caps have been on a roll, that won't always be the case. Pullbacks can and do happen. In good times or bad, though, our objective, and that of our preferred investor, remains long-term outperformance.

Turning back to the present, the Fund's gains were unusually broad-based during December with 11 holdings making larger contributions than the headwind created from the largest detractor. The most significant contributor to performance during the month was **Afterpay Touch** (+19.4%), while the most significant detractor was **Bapcor** (-4.2%). We remain enthused about the long-term prospects of both companies.

The Fund's 5 largest holdings as of the end of December accounted for 36.4% of the portfolio, and are named in order of the Fund's allocation. Each should look familiar to investors as we've profiled them at different points in prior investor letters: **Afterpay Touch** (ASX:APT), **BWX** (ASX: BWX), **Gentrack** (ASX:GTK), **Altium** (ASX:ALU) and **Pro Medicus** (ASX:PME).

The Fund continues to look very different to its benchmark and the broader Australian market. We consider that a positive as it is driven by our emphasis on quality and growth plus a willingness to take high-conviction positions. The Fund's largest sector allocations as of the end of the month were information technology (66.4% of total capital), consumer staples (7.3%), and healthcare (6.0%).

2 Successful Exits

The Fund exited two positions during the month that at previous points were top 5 holdings: **Aconex** (ASX:ACX) and **WiseTech Global** (ASX:WTC). The outcomes were pleasing as, over the course of ownership across each holding, the Fund realised capital gains of 21.6% and 89.9%, respectively.

We exited the Fund's remaining position in Aconex following the announcement that the board unanimously supported accepting an all-cash offer of $7.80 a share from US enterprise software giant **Oracle** (NYSE:ORCL). The offer was stout at a 47% premium to the previous closing price and at an enterprise value greater than 8 times consensus revenue for this fiscal year.

We sold out the Fund's position after the deal was announced as the shares sold for only a modest discount to the offer price, we saw little chance of a higher bid coming along given the steep premium Oracle had offered, and that we saw Oracle as the natural owner of the business.

Following the announcement, we thought the most likely outcome was that the shares may appreciate by roughly 2% to the offer price over the next few months while a worst case was that the deal may fall apart for whatever reason and send the shares tumbling. Such low-upside, high-downside scenarios are precisely what we try to avoid at Lakehouse and thus we thought it best to cash out and look to redeploy that capital elsewhere.

Alas, our team had already lightened the Fund's position prior to the deal's announcement as the shares had been on a run, but it was a welcome boost nonetheless and a vindicating outcome for a holding that was at one point the most shorted stock on the ASX. Also, more broadly, we think the steep premium Oracle paid for the business speaks to a relative undervaluation of high-growth Australian technology companies relative to their global peers.

Turning to WiseTech Global, the Fund began reducing its stake in the latter half of this calendar year as we grew increasingly uncomfortable with the company's surging valuation and increased pace of acquisitions. We exited the balance of our stake in December.

For context, the Fund built its position in WiseTech at a time when the shares sold in the ballpark of 55 times consensus adjusted earnings for fiscal 2017, and roughly a year later we sold the last of the Fund's shares at a valuation of roughly 85 times consensus adjusted earnings for fiscal 2018. WiseTech's shares deserve a premium for reasons we've discussed previously, however, the share price is at a point where we no longer think the range of outcomes is skewed in investors' favour.

It also does not help that WiseTech has been on an acquisition spree. The company has been quite up front that acquisitions were an important part of their growth strategy, however, the 10 that they've announced in the first half of this fiscal year is a bit much for our taste. We think the company has taken on a meaningful amount of execution risk in the process that, combined with the rich valuation, makes for a meaningfully less attractive thesis than when we initiated the position.

Again, we remain fans of the core business and could picture the Fund once again owning a stake in WiseTech, but we'd need to see a more attractive valuation and evidence that the company had successfully digested its recent acquisitions before diving back into the pool.

Looking Ahead

The next couple of months should be lively as reporting season kicks into high gear in February. We look forward to receiving updates from our portfolio companies, sitting down with company leaders, exploring new opportunities, and redeploying the profits that we've recently taken.

Thanks to all our investors for your time and trust. We're honoured to have you with us and look forward to what the future holds.

Best Regards,

Joe Magyer, CFA
Chief Investment Officer

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