

## LAKEHOUSE SMALL COMPANIES FUND LETTER

### 31 JANUARY 2018

Companies Held:	19
Cash Allocation:	11.0%
Top 5 Portfolio Holdings:	36.9%
Net Asset Value per Unit:	\$1.4547
Fund Net Asset Value:	\$143.4 million
Benchmark:	S&P/ASX Small Ordinaries Accumulation Index

Dear Lakehouse Investor,

The Lakehouse Small Companies Fund posted a strong start to 2018. A number of our portfolio companies released their quarterly 'Appendix 4C' cash flow reports, providing much insight into the first fiscal half of 2018. By and large, results have been pleasing thus far and this has been borne out in the portfolio's return.

The Fund returned 4.2% net of fees and expenses in January compared to a -0.5% fall for the benchmark. The Fund has now returned a net 35.6% thus far in fiscal 2018 compared to 18.1% for the benchmark. Since inception in mid-November 2016, the Fund has returned a net 46.6% compared to 24.3% for the benchmark.

We are pleased with the Fund's recent performance, particularly as the Fund has zero direct exposure to the sectors with the first- and third-largest contributions to the benchmark's gains this fiscal year, materials and energy. As we remind investors in every letter, though, our team does not judge itself based on short-term results and neither should investors who embrace our long-term, high-conviction strategy.

The Fund's most significant contributor to performance during the month was **Afterpay Touch** (+23.3%), which announced a strong quarterly business update and a potential push into the US, while the most significant detractor was **Gentrack** (-10.6%), which gave back some gains after a strong run. We remain enthused about the long-term prospects of both companies and will provide more commentary on Afterpay Touch after the company reports.

The Fund's 5 largest holdings as of the end of January accounted for 36.9% 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), **Altium** (ASX:ALU), **BWX** (ASX: BWX), **Gentrack** (ASX:GTK), and **Bapcor** (ASX:BAP).

The Fund continues to look very different to its benchmark and the broader Australian market. The Fund's largest sector allocations as of the end of the month were information technology (68.9% of total capital), consumer staples (7.0%), and consumer discretionary (5.7%), which is a stark contrast to the benchmark's largest allocations: materials (18.7%), consumer discretionary (18%), and real estate (11.1%).

We consider the Fund's divergence from the benchmark a positive as it is driven by our emphasis on quality and growth plus a willingness to take high-conviction positions. More specifically, at the position level the Fund is searching for opportunities that present the following characteristics:

- Strong positions in growing markets.
- Pricing power with customers and suppliers.
- Durable competitive advantages grounded in: scale, strong brands, network effects, or high customer switching costs.
- Aligned and experienced management teams with strong track records of capital allocation.
- Conservative balance sheets.
- Attractive valuations that afford upside to our estimate of fair value.

The reality is that few companies present most of the above traits, and the ones that do are not typically found in cyclical, capital-hungry sectors such as materials, energy, or real estate. We much prefer to instead focus our time and capital on slices of the market known for high customer loyalty such as enterprise software and consumer brands.

Indeed, of the 19 companies in the portfolio today, 17 have business models built around some form of subscription or long-term agreements. We sleep well knowing our portfolio companies have earnings streams that are, at-large, far more visible and less cyclical than the market.

## Looking Ahead

February is an exciting time for our team as reporting season brings fresh news. We're long-term investors and do not get too hung up on half-yearly performance, however, we look forward to receiving updates from our portfolio companies, sitting down with company leaders, exploring new opportunities, and putting capital to work.

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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