LAKEHOUSE CAPITAL
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Lakehouse Small Companies Fund (ARSN 615 265 864) (Fund). The responsible entity for the Fund is One Managed Investment Funds Limited (ACN 117 400 987) (AFSL 297042).

LAKEHOUSE SMALL COMPANIES FUND QUARTERLY LETTER 31 DECEMBER 2016

Companies Held:	**19**
Cash Allocation:	48.3%
Top 5 Holdings of Portfolio:	29.9%
Portfolio Value:	$87.2M
NAV per Unit:	$0.9794

Dear Lakehouse Investor,

Welcome to the very first quarterly letter from the Lakehouse Small Companies Fund. It's been an exciting couple of months for all of us. In fact, enthusiasm to invest in the Fund was so strong that we felt it best to soft-close to new investors on 21 December 2016. Existing investors are still free to top-up or redeem their investments as usual, but mostly, new investors will have to wait until we've put more of your capital to work before we reopen our doors.

As of the end of December the Fund's net asset value sat at $87.2 million -- a big number for a fund in its second month. We're honoured by the significant trust that all our investors have placed with us, and we're hustling to put your capital to work into a high-conviction portfolio whose long-term prospects we're excited about. And, as we go along, we'll update you with quarterly and annual letters that keep you plugged into our strategy and outlook plus the portfolio's key holdings, themes, and performance.

Benchmark & Performance

The objective for our fund is to outperform its benchmark, the S&P/ASX Small Ordinaries Accumulation Index, over rolling five year periods on a total return basis after fees and expenses but before taxes.

The benchmark accounts for dividends and includes the smallest 200 companies of the S&P/ASX 300 -- that is, it excludes the S&P/ASX 100 companies. We opted for this benchmark because most of our holdings fit into that slice of the market and, more to the point, this index is the most widely accepted benchmark among Australian small-cap funds.

Unlike our broadly diverse benchmark and its 200 companies, we manage a high conviction portfolio focused on typically 15 to 30 holdings at a time. (The Fund held stakes in 19 companies as of the end of the quarter). We prefer to back our top ideas and see little value in putting your capital behind our, say, 31st-best investment idea. Rather than act as closet indexers who tilt their way around benchmarks, we much prefer to invest in a smaller basket of what we consider superior businesses that we feel we know very well.

Another point of differentiation between the Fund and our benchmark is that we tend to have a very different industry mix, not only because of our high-conviction strategy but also because we prefer to focus our efforts into sectors we know well and have historically attractive economics. In other words, we expect to typically be light on the likes of biotech (too complex) and materials (too cyclical and capital-intensive) while being overweight companies and sectors with historically high returns on invested capital and stable earnings, such as enterprise software and (some) consumer staples.

Given that we're executing on a high-conviction strategy, and that we tend to lean differently than our benchmark, you can expect benchmark and fund returns to consistently look different over the short-term. This quarter was no exception.

From inception on 16 November through the quarter end the Fund registered a loss of 2.1% compared to a 4.2% gain for the benchmark. Cash drag was a factor as the Fund has been sitting on an atypically large cash allocation as we patiently put our foundational investors' cash to work.

An unrealised loss on **Bellamy's Australia** (-73.3%) overshadowed a net gain on the rest of our invested capital, including meaningful gains on our stakes in **Bapcor** (+17.6%) and **Aconex** (+8.4%), both of which are among the Fund's five largest holdings.

We've previously discussed Bellamy's downgrade and the decision to voluntarily mark down the holding to reflect the latest information in the midst of the lengthy suspension. We look forward to an update from Bellamy's soon and will have more to say on the company's travails and its looming boardroom battle once it updates the market, and its shares trade again.

It's an inauspicious start, but also early days. For context, the six-ish weeks we've measured this first 'quarterly' over is less time than Kriss Kross' "Jump" spent at the top of the charts. We're continuing to play the long game, methodically putting your capital to work, and are very enthused about the companies we own today.

The Big Picture

When it comes to portfolio management, we tend not to cut our Scotch with too much water. We prefer to invest in a high conviction basket of superior businesses that we know very well. Alongside this, we buy companies with a view to owning them for the long-term, not as short-term trades.

At the individual position level, the companies we own typically hold the following attributes:

- Strong positions in growing markets.
- Pricing power with customers and suppliers.
- Durable competitive advantages grounded in scale, strong brands, network effects, or high 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 portfolio we've constructed thus far speaks well to these attributes.

Our basket of companies grew their sales by 25.0% over the past year on a value-weighted basis, for example, which is head and shoulders above the 6.0% for the iShares S&P/ASX Small Ordinaries ETF, which is a clean proxy for the benchmark.

Our companies also have highly visible earnings thanks to business models built upon recurring revenue. 16 of our 19 holdings have models specifically built around subscriptions and/or long-term contracts, while the remaining three still stand apart from the pack thanks to strong brands or longstanding relationships.

Speaking of relationships, we've spent a great deal of time getting to know the leaders of our companies: We had 15 meetings with executives at our portfolio companies during the quarter. The boards and managers at these companies also have plenty of skin in the game, with insiders at our top five holdings owning around 12.5% of their companies on a value-weighted basis, or more than $360 million worth of shares. Suffice to say they are well aligned and motivated.

Unlike the benchmark, where companies by and large have a net debt position, our companies collectively hold a net cash position. In fact, 17 of the 19 have more cash than debt. Next time the economy runs into trouble we expect our companies will be well placed to play offense while less conservative rivals may be forced into playing defence.

We're also pleased with the valuations on the entry points of our companies. We were fortunate to launch at a time when many small-caps had been sold down aggressively for non-fundamental factors, and we've invested accordingly. Indeed, the average cost basis for our top five holdings as of the end of the quarter was, on a value-weighted basis, 25.5% below the companies' respective 52-week highs.

One more thing: Our investments are also less widely followed than you'll read about in the newspaper or find in the benchmark. According to Bloomberg, the average number of analysts following companies in our portfolio is just above five, while the average for the members of the small-cap index is above eight. In other words, the average holding in our portfolio is followed by around 1 in 3 fewer analysts than the benchmark, which we think gives us a chance to get ahead of the curve.

Key Holdings

We plan to disclose our five largest holdings in our quarterly reports and, depending on the circumstances, comment on positions we've recently filled, closed, or played an important role in our performance. As with most small-cap funds, we don't plan to disclose all our holdings because we don't want other investors to front-run the Fund on positions we're building or reducing.

Below were our five largest positions as of 31 December 2016:

Company	Allocation
Altium (ASX:ALU)	7.0%
Bapcor (ASX:BAP)	6.8%
Aconex (ASX:ACX)	6.1%
Citadel Group (ASX:CGL)	5.6%
GBST (ASX:GBT)	4.3%
Total Top 5 Holdings	**29.9%**

You might have noticed a few enterprise software companies among our largest holdings. Enterprise software companies, who develop and sell software to other organisations, tend to have loyal customers and attractive economics.

Software that is deeply integrated into a company's workflow is the business equivalent of the Hotel California, where patrons are prisoners of their own device. Habit and inertia are powerful sedatives, and CIOs and CFOs are usually loathe to fork over cash to replace functional systems, especially if they're deeply integrated and changing them could disrupt operations.

Examples abound of how deeply integrated software can be hard for customers to wean themselves from. The Australian Bureau of Statistics, for example, admitted in 2015 that some of its critical IT infrastructure components are over 30 years old. Some British nuclear submarines are still running on a version of Windows XP, which was released in 2001.

Stark examples exist within our own portfolio as well. For example, another holding of ours, **WiseTech Global**, reported in its prospectus last year that its 10 largest customers by revenue had been with the company for more than 10 years.

Ultimately, we're fond of this space because its star players tend to tick the boxes of the qualities we described earlier. Among them is our largest position, **Altium**. Altium's flagship product, Altium Designer, helps engineers design printed circuit boards (PCBs), which are like the little brains in your electronics. Altium's software has over 31,000 subscribers spread around the world, among them engineers at BMW, Boeing, NASA, Cochlear, Microsoft, and numerous other high-profile clients in a range of industries.

We see multiple ways for Altium investors to win. The core business is thriving as new license sales accelerated throughout 2016, retention rates increased each of the past two years, and the company passed on a 5.7% price increase to renewing subscribers at the start of this fiscal year. Altium's partnership with Dassault Systèmes could also pay off handsomely. The arrangement introduces Altium to a wider audience and opens the door for a potential sale to the highly acquisitive Dassault, which has made at least 14 acquisitions during the past five years.

Finally, Altium has a new higher-end offering that has long been in the works, Atina, slated for launch early in 2017. Atina will allow Altium to encroach upon a lucrative new tier of the PCB design market but, even more importantly, allow the company to upsell and retain existing Altium Designer customers looking for a more feature-rich product. While we'd be surprised if more than 5% of users upgraded it still makes for a nice layer of icing on Altium's cake as we estimate that upgrading a Designer subscriber into Atina more than triples the lifetime value of that subscriber.

Meanwhile, we think our downside is protected by the company's 2.5% yield, $38 million in cash against zero debt, and a diverse customer base that spans varied end markets. CEO Aram Mirkazemi's 7.5% stake in the company is also comforting, and we think the shares are very attractively priced for their growth profile at under 25 times our estimate for earnings per share in fiscal 2017.

Bapcor is another key holding in our portfolio. Bapcor, which came public as Burson Auto Parts in 2014, has its roots in selling and distributing parts to the mechanics who fix our broken-down rides and get us back on the road.

Auto parts distribution is as steady as it is dull, which is good by us, and the business model is one of the few anti-fragile ones you'll find. When times are tough drivers invest more cash into keeping their current rides on the road, and that means more parts from Bapcor.

What's more, few drivers shop around on part prices when they're getting their car fixed because their top priority is getting back on the road as soon as possible, plus labor is a larger (and easier to negotiate) expense. That lack of caring about prices by the consumer translates into considerable pricing power for Bapcor's distribution business, which rarely has trouble passing along higher prices.

Bapcor's trade margins have steadily risen over the past few years and we expect that to continue as the company steadily rolls up a fragmented trade market, while also biting into the wholesale segment value chain. Most auto parts distributors are sub-scale mum-and-pop shops that can't match the price, range, availability, speed-to-customer, or ability to service regional and national accounts as can Burson. Burson's advantages slowly squeeze smaller rivals and, for the ones that end up selling to Burson, the company is able to immediately boost profitability thanks to its superior buying power and increase range and availability thanks to its existing large network.

The company has thrived under the leadership of CEO Darryl Abotomey, who has led the business since October 2011 and previously served as the CFO of Burson's largest rival, Repco. We have great confidence in Abotomey, who has proven a rare combination of a talented operator and capital allocator. We expect Bapcor's gross margins to quietly but steadily rise over the years as its growing scale affords it better buying power while market consolidation leads to less price competition.

We are also pleased that Bapcor has secured a majority stake in New Zealand-based **Hellaby Holdings**. Hellaby is the owner of a hodge podge of assets, including a wholesale and distribution auto parts business that would fit nicely within Bapcor. Having studied Hellaby and spoken with its CEO, we think that Hellaby has been undermanaged, and that Bapcor will effectively divest non-core assets while strengthening and growing the more attractive, relevant parts of its business.

Bapcor is one of the few companies in our portfolio that consistently carries a good bit of debt, however, we think that is entirely appropriate given the very, very steady nature of the business. Plus, Bapcor is creating significant value for shareholders by using low-cost debt to gobble up smaller rivals at very favourable prices, and then going a step further by improving the target's profitability.

Bapcor's shares have been on a bit of a run since we built our stake but we view this as a core holding and have no intention of cashing out. Bapcor is very well managed, a major player in a fragmented industry, and one of the few truly countercyclical companies listed in Australia or New Zealand. The company also has a habit of under-promising and over-delivering, which goes a long way with us.

And now you've been introduced to our two largest positions. We plan to weave in discussions on individual holdings in each quarterly report, rotating the mix as we go.

In Conclusion

On behalf of the Lakehouse Capital team, thank you for joining us at the outset of this long journey. We're honoured by your trust and look forward to serving you in the years ahead.

Happy New Year,

Joe Magyer, CFA

Chief Investment Officer

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