Dear Lakehouse Investor,

Companies Held:	22
Cash Allocation:	12.6%
Top 5 Portfolio Holdings:	35.8%
Net Asset Value per Unit:	$1.4019
Fund Net Asset Value:	$166.4 million
Benchmark:	S&P/ASX Small Ordinaries Accumulation Index

January was a better month for investors as equity markets rebounded. The Fund was active in both buying and selling during the month as we continued to build the new position outlined in the December letter, and we also exited a small holding where the investment thesis was not playing out as expected. Despite the selling, the Fund was a net buyer during January, and remains well positioned to take advantage of any opportunities that shake loose during reporting season.

Turning to performance, the Fund returned 7.3% net of fees and expenses in January compared to a 5.6% return for the benchmark. For the fiscal year, the Fund has returned a net -0.2% compared to -7.9% for the benchmark. Since inception in mid-November 2016, the Fund has returned a net 47.9% compared to 20.5% for the benchmark.

While it is pleasing to see a positive month following 3 consecutive down months to close out calendar 2018, we do not judge ourselves on short-term performance and neither should investors who embrace our long-term, high-conviction strategy. As ever, we remain focused on our ultimate objective of long-term outperformance.

The Fund’s most significant contributor to performance during January was **Afterpay Touch** (+28.3%), which updated the market on its preliminary half year results and business developments. More on that later. The biggest detractor was **RPM Global** (-12.9%), a position that we haven’t previously discussed in these letters but will shortly.

The Fund’s five largest holdings as of the end of January accounted for 35.8% of the portfolio and are named in order of the Fund’s allocation: Afterpay Touch, **Pro Medicus**, **Altium**, **Citadel** and **Bapcor**. Longtime investors may recognise each of these names as they’ve been Fund holdings for some time.

Zooming out, the Fund’s largest sector allocations as of the end of the month were to information technology (69.5% of total capital), health care (11.7%), and consumer discretionary (5.2%), which is quite different to the benchmark’s largest allocations: materials (19.5%), consumer discretionary (14.8%), and real estate (11.6%).

We continue to embrace a differentiated approach with an emphasis on companies and industries known for capital-light, recurring-revenue-centric business models. To that end, and considering the soft state of the Australian and Chinese economies, we are even more comfortable than usual being significantly underweight the likes of materials, consumer discretionary, and real estate.

Company News

Afterpay continued its run of strong growth in the first half of fiscal 2019, which included the important Christmas retail period. Underlying sales across the business over the six months exceeded $2.2 billion, up an impressive 140% on the prior year. While the bulk of those sales -- approximately $2 billion -- came from the more-established Australian and New Zealand market, the nascent US business is off to a roaring start and now has 650,000 users, or just over 20% of the company's total user base.

Afterpay US, which only launched in May, processed $260 million in underlying sales in the half. This is an incredible start for a business that is only 8 months old, especially considering it took Afterpay around 28 months to achieve that same level in Australia. The pace of growth in the US in less than a year speaks to the immense size of the opportunity in that market.

Growth of the Afterpay network accelerated during the December quarter as an average of 7,500 new users per day were added. There was also strong growth on the other side of the network with an average of 35 new merchants added per day, taking the total number of global merchants using Afterpay beyond 23,000 at the end of 2018. Afterpay's footprint is set to continue expanding across the globe with a launch in the UK market imminent. We look forward to hearing more about the company's global growth plans during the upcoming half year results roadshow.

Another bright spot for the company was the material fall in late fees to below 20% of revenue, down from 25% previously, while net transaction losses held steady at *"the lower end of the 0.6%-1.0%"* guidance range. This is particularly impressive given the US launch -- losses tend to spike in new markets as new users have the highest default rates -- and the fact that late fees were capped in 2018. It's also worth noting that the Australian regulatory environment has softened toward the buy-now-pay-later industry, which has helped reignite the market's enthusiasm for the company and its bright prospects.

Let's turn back the Fund's newly disclosed position, RPM Global. RPM is a service provider to the global mining industry and long-time holding of the Fund. Of its three business units, Lakehouse is most enthused by its software division, which is benefitting from having invested heavily into its product suite during the mining downturn while many rivals were pulling in their horns. We are also enthused about the company's ongoing shift towards a recurring-revenue-centric model.

RPM ticks many of the boxes we look for in an investment. It is run by a very commercial and capable leader in Richard Matthews, who has a strong track record of capital allocation and has deep experience buying, integrating, and selling software companies. Richard, along with other company insiders, has strong alignment with shareholders owning around a third of the business. RPM is growing into a large and growing global market, and is well placed to deliver on its growth plans with a cash-heavy balance sheet. Lastly, we'll note that only 1 broker covers the company, suggesting the market still has a lot to learn about the business and its transformation.

Looking Ahead

February and March will be eventful as half-year reporting season gathers steam. We look forward to receiving updates from our portfolio companies, sitting down with executive teams, and exploring new opportunities. To that end, our team has held 350 company meetings since the Fund launched in November 2016.

Thanks to all our investors for your time and trust. It was not lost on us that the Fund had net inflows during the challenging fourth quarter of calendar 2018, and we're honoured to have such a long-view group of investors on board with us. We'll keep hustling for you.

Best Regards,

Joe Magyer, CFA
Portfolio Manager, Lakehouse Small Companies Fund
Chief Investment Officer, Lakehouse Capital