Dear Lakehouse Investor,

Companies Held:	21
Cash Allocation:	15.4%
Top 5 Portfolio Holdings:	34.7%
Net Asset Value per Unit:	$1.5026
Fund Net Asset Value:	$179.6 million
Benchmark:	S&P/ASX Small Ordinaries Accumulation Index

February was a busy month as most of the Fund's portfolio companies reported half-yearly results. On top of digesting results, our team hustled to catch up with 14 different companies and was active in both buying and selling during the month.

We have a strong bias towards patience when it comes to trading, however, we do make exceptions and multiple examples popped up this month. For example, the Fund took profits on some positions that have done exceptionally well to the point of creating position sizing issues. The Fund also increased its holdings in some companies where our investment thesis has strengthened and, conversely, trimmed or outright exited positions where the fundamentals weren't lining up with our expectations.

The confluence of these moves increased the Fund's cash position from 12.6% to 15.4% over the course of the month. The 15.4% position in cash is above the higher end of the Fund's typical range, however, the degree of selling in February was above-average for the Fund and we are actively evaluating putting more cash behind both some existing holdings as well as potential new positions.

Turning to performance, the Fund returned 7.2% net of fees and expenses in February compared to a 6.8% return for the benchmark. For the fiscal year, the Fund has returned a net 7.0% compared to -1.6% for the benchmark. Since inception in mid-November 2016, the Fund has returned a net 58.5% compared to 28.7% for the benchmark.

While it has been a pleasing couple of months after the rough ending of 2018, our team does not judge itself 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 February was **Afterpay Touch** (+32.3%), which reported its half-year results and new business developments. More on that later. The biggest detractor was **Citadel** (-19.4%) which we've discussed in these letters previously and will touch on shortly.

The Fund’s five largest holdings as of the end of February accounted for 34.7% of the portfolio and are named in order of the Fund’s allocation: Afterpay Touch, **Altium**, **Pro Medicus**, **Audinate** and **Nanosonics**. While the first three positions are well known to existing investors as long-time holdings this is the first time we’ve disclosed the Fund’s holdings in Audinate and Nanosonics, which we’ll discuss in next month’s letter.

Zooming out, the Fund’s largest sector allocations as of month-end were to information technology (67.1% of total capital), health care (12.4%), and consumer discretionary (3.9%), which is quite different to the benchmark’s largest allocations: materials (18.7%), consumer discretionary (15.1%), and information technology (11.9%).

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

We spoke about Afterpay Touch at some length in the January letter following its preliminary update, plus I (Joe here) wrote a commentary you can find on our website about the half-year results, so we won’t spill too much digital ink on the subject.

Big picture, we were pleased that the Senate inquiry into financial services that caught up ‘buy now, pay later’ providers (BNPLs) such as Afterpay eventuated with little consequence for BNPLs. Meanwhile, we were pleased to get more metrics from Afterpay Touch’s half-yearly report, particularly that gross losses and late fee income both fell materially as a percentage of underlying merchant sales.

We were also impressed that Afterpay now has more than 1 million users in the US despite only launching 10 months ago, reaching that milestone in less than half the time it took in Australia. We’re conscious that transaction costs are higher in the US than Australia, however, we think that still leaves plenty of margin headroom as loss rates should fall as the business scales, which we’ve seen in Australia. Also, transaction growth going forward should increasingly tilt towards small-and mid-sized merchants who pay considerably higher fees to Afterpay than do enterprise customers (e.g. Urban Outfitters).

The company’s ongoing success is also increasing its optionality. For example, the strong take up in Australian ecommerce opened the door to a fast-growing in-store business, and success in the US has helped line up key partners for the upcoming UK launch. The company’s loyalty among users affords new product options as well. For example, the company made the not-so-subtle point in sharing that it is now the second-largest driver of leads to Australian merchants’

websites, trailing only advertising giant Google. We also wouldn't be surprised to see Afterpay follow the lead of US rival Affirm by creating some form of a savings vehicle for users.

As we've long emphasised, Afterpay Touch has a wide range of outcomes, and we've taken some profits recently as the surging share price forced us to right-size our position. Still, we think the skew looks attractive given the company's execution and expanding market opportunities.

Altium has been a quiet yet remarkable outperformer for the Fund. The company delivered yet another impressive result in February as revenue and EBITDA increased 24% and 49% year on year, respectively, thanks to broad-based growth and continued operating leverage. There's a lot to be optimistic about as growth in new seat sales for the company's flagship product, Altium Designer, accelerated for the second first-half in a row. Meanwhile, revenue in China increased 49% year on year, revenue at its electronics parts search business is now meaningful and grew 80%, and the company said that its pipeline for its cloud-based, high-end Nexus design product is so large that it can't handle the demand right now (a first class problem).

What's particularly unusual about Altium is that it has been able to grow at such rates so profitably and with such limited reinvestment. On profitability, the company posted a pre-tax profit margin of 34.0% in the half despite expensing all of its research and development costs. And on capital efficiency, the company's pre-tax profit excluding unusual items increased by US$14.6 million over the trailing fiscal year on an increase in book value of only US$24.3 million over the same period. If any investors know of other businesses with such economics listed on the ASX, please contact us immediately.

We are also enthused about the upcoming launch of Altium 365, which is a cloud-based platform that will allow Designer users to directly interface with manufacturers. The big idea here is that connecting design with manufacturing will reduce friction on both sides, enabling designers to get their ideas turned into reality sooner and for manufacturers to receive orders they otherwise wouldn't and to make better use of untapped capacity. We're not overweighting the potential here just yet -- we view this as an out-of-the-money call option as it hasn't even launched -- but should this two-sided network gain traction it could open numerous monetisation angles, including driving market share gains and boosting renewal rates of Altium Designer as its users will have free access to the platform.

Altium's shares have been on a huge run -- the February-end price of $32.84 is a good deal higher than the Fund's roughly $8 average cost on the stake it built in late 2016 and early 2017 -- and we have taken profits for the Fund along the way to keep the holding's size in check. Still, it is rare to find small companies on the ASX that offer Altium's mix of growth, efficiency, and optionality, and so we continue to hold a meaningful position in the company.

Pro Medicus was no slouch either with its half-year results. Revenue increased 59.4% year on year with underlying after-tax profit increasing 79.9% thanks significantly to the successful

implementations of Yale and Mayo Rochester. The company continues to pick up impressive reference clients -- 2 of the top 4 US hospitals are now customers -- and so it is no surprise that the company reports having a strong pipeline. Also positive is that the company has a handful of good-sized customers going live in the next few quarters.

Like Altium, the market has warmed to this fast-growing, high-margin, debt-free business that is gaining share of a growing market. And, like Altium, we've taken some profits to keep the position size in our comfort zone. Lastly, again like Altium, we think the investment case for Pro Medicus is not only strong but has strengthened, and so we're comfortable maintaining a good-sized stake in the business.

Finally, we'll turn to the Fund's largest detractor during the period, Citadel. The shares sold off after the company reported revenue growth of only 5.5%, some 12% short of consensus expectations, and a fall in profit margins. Citadel has a history of being back-half-weighted, and has previously stated that is expected to be the case again in FY19, though it seems this is less appreciated by the market. Also, the resignation of one of the company's founders, and deputy chair, shortly before the results did little to calm investors.

On a brighter note, Citadel's SaaS revenue remains the fastest growing portion of the business (up 39.1% on the prior corresponding half) and now accounts for around a third of total revenue. This mix shift to SaaS has come at a cost so far, though, as it pushed group gross margins down 2.9 percentage points to 47.3% during the half. We expect that trend will turn, however, as the SaaS customer base seasons and the high implementation and customer onboarding costs are lapped. Citadel also claims a record weighted pipeline of business, of which 70% is SaaS, so it is easy to picture both increasing growth margins over time as well as decreasing seasonality, earnings volatility, and customer conception. Ultimately, while the mix shift towards SaaS could make for a choppy short-term, we continue to like the long-term prospects of the business.

Looking Ahead

March captures the tail-end of half year reporting roadshows, and provides a quieter period for turning over stones with fresh financial statements at hand. We also anticipate the recent pick up in equity markets will see a pick up in IPO activity between now and full year reporting in August.

One last thing. We'd also like to take the opportunity to highlight that the Fund plans to reduce the minimum initial investment amount to $100,000 starting mid to late March. The initial minimum at launch served the Fund well in terms of forming a base of strongly aligned, high committed investors, and we're extremely grateful from the trust demonstrated by those investors. We've come to appreciate that a wider base of investors makes for an even more solid core, though, and our team is excited about serving a wider audience of investors. The Fund will issue an updated product disclosure statement as part of the change and, naturally, we

encourage existing and potential investors to give it a read. The updated PDS will be available on our website.

Thanks again to all our investors for your time and trust.

Best Regards,

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

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