Dear Lakehouse Investor,

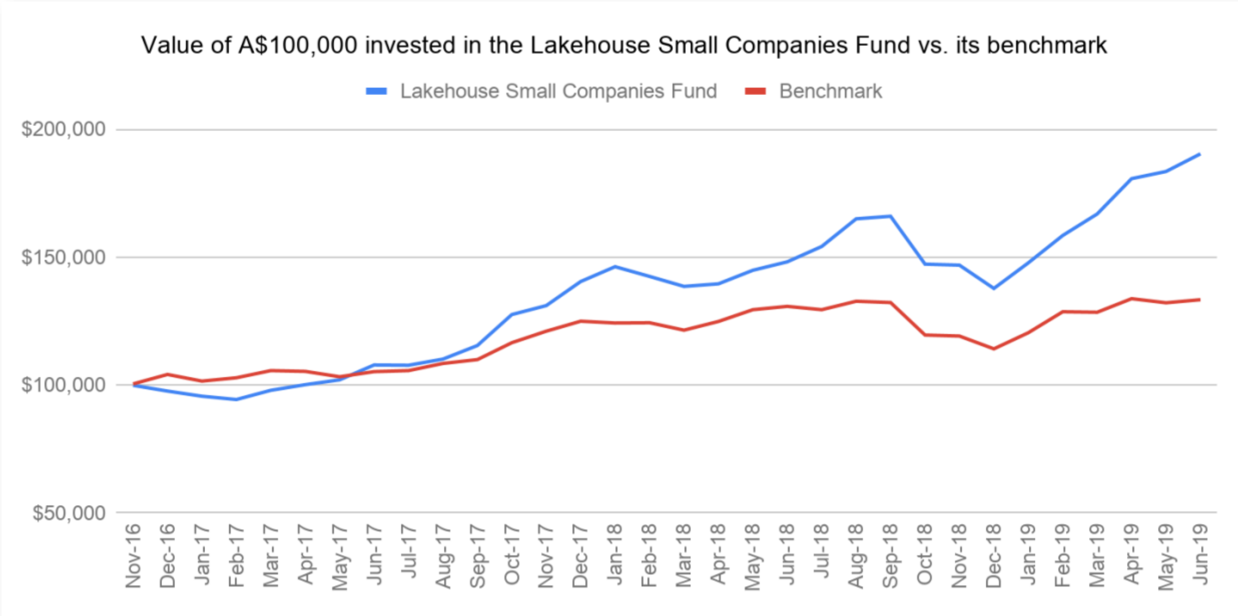
Companies Held:	20
Cash Allocation:	10.9%
Top 5 Portfolio Holdings:	38.9%
Net Asset Value per Unit:	$1.7387 (ex 6.6 cent distribution)
Fund Net Asset Value:	$222.1million (ex $8.4 million distribution)
Benchmark:	S&P/ASX Small Ordinaries Accumulation Index

2019 was a very good year for the Lakehouse Small Companies Fund. The Fund returned 28.5% net of fees and expenses compared to a 1.9% return for its benchmark. For context, the Fund ranked number one out of 86 peers in the *Morningstar Equity Australia Mid/Small Blend category. Zooming out further, the Fund has returned a net 90.3% since inception in mid-November 2016 compared to a 33.4% return for its benchmark.

We are pleased with the Fund's progress towards its goal of long-term outperformance, however, we're eyes-wide-open that our growth-focused, high-conviction approach means the Fund will experience periodic bouts of underperformance. We do not get fussed over short-term zigs and zags, though, as evidenced by the Fund still owning 13 out of the 24 companies it owned two years ago, making for an annualised position-level turnover of over four years.

The Fund's low turnover and emphasis on capital appreciation makes for a lumpy income stream. The final distribution of 6.61 cents per unit brought the total distribution paid to unitholders for the 2019 fiscal year to 7.48 cents per unit. We're pleased for these distributions to have been dished out to those investors who elected not to reinvest, however, we remind investors that we manage towards long-term total returns, not current income, and that we expect the ultimate distribution sizes to bounce around considerably from year to year.

Speaking of not taking things for granted, our team does not take the Fund's early success as a given and continues to hustle to find new opportunities, better understand our current holdings, fine-tune our process, and evolve our own business to better serve investors. We turned over many rocks, caught up with companies 121 times during the year, and have been pitched a total of 225 IPOs, pre-IPOs, and institutional placements since inception. Lakehouse is also reinvesting in itself by upgrading to more robust order and portfolio management systems and have hired two new investment analysts, an operations manager, and a business development manager.



Note: Fund performance is based on monthly ending NAV and includes distributions. The benchmark for the Fund is the S&P/ASX Small Ordinaries Accumulation Index. Past performance is not an indicator of future performance.

The Fund continues to look very different from its peers, reflecting our long time horizon, embrace of active share, and a focus on the businesses that have the traits we seek. Namely, we're after companies that offer:

Strong positions in growing markets. Industry leaders capture an outsized share of industry profits, and growing markets put the wind at their backs. This is all the more true in the winner-take-most markets for which we have a particular fondness.

Pricing power with customers and suppliers. Pricing power is the financial distillation of a business' competitive position. Little wonder that many of the world's most successful businesses are price setters while laggards are price takers.

Durable competitive advantages grounded in scale, strong brands, network effects, or high customer switching costs. We have a penchant for businesses with wide and widening moats. In particular, we're fond of businesses with extremely loyal customers and highly visible recurring revenue streams, especially given the soft domestic economy. We estimate that about 76% of the fund's invested capital is in businesses where more than half of revenue is generated from explicit recurring revenue sources such as subscription or maintenance agreements compared to only about 30% of the benchmark.

Aligned and experienced management teams with strong track records of capital allocation. The importance of management increases exponentially next to a company's growth and reinvestment rate. As it happens, our portfolio companies are collectively growing very quickly, so we make it a point to get to know the people leading our companies. That's why members of our team have caught up with leaders of our current 20 portfolio companies a total of 161 times.

Conservative balance sheets. A well capitalised business will almost always live to see another day. One better, they can play offence while others play defence. We're not dogmatic on owning businesses without debt -- some businesses are far more valuable to shareholders when a prudent amount of leverage is applied -- but we have a strong bias towards balance sheets with untapped capacity.

Attractive valuations that afford upside to our estimate of fair value. Valuing the types of high-growth companies we prefer is an exercise in false precision. Nonetheless, while we're not slaves to spreadsheets, we strive to pay prices that we think boost the odds of a favourable outcome.

All that leads to a significantly different portfolio relative to our peers and the broader market. The Fund's portfolio companies are growing faster (47.6% revenue growth over the past reported year compared to 19.6% for the benchmark) and receive much less attention (an average of 6.1 analysts following them compared to 8.5 for the benchmark).

The sector tilts also look quite different as the fund's largest sector allocations are to information technology (63.7%), healthcare (14.6%), and consumer discretionary (4.5%) compared to the benchmark which is led by materials (20.5%), consumer discretionary (14.4%), and real estate (11.6%). We have a strong preference towards spaces with high and persistent returns on invested capital (e.g. software and household products) and away from those that are capital intensive (e.g. materials and energy) and highly competitive (e.g. retail and transportation).

The Fund's tilt towards IT has been a tailwind as the sector has been the second-best performing behind industrials since launch. That said, we note that about 38% of the Fund's outperformance since inception came via stock selection, not just sector selection. We're also pleased with the Fund's performance since inception in risk-adjusted terms with a Sortino ratio of about 1.53 compared to about 0.84 for the benchmark.

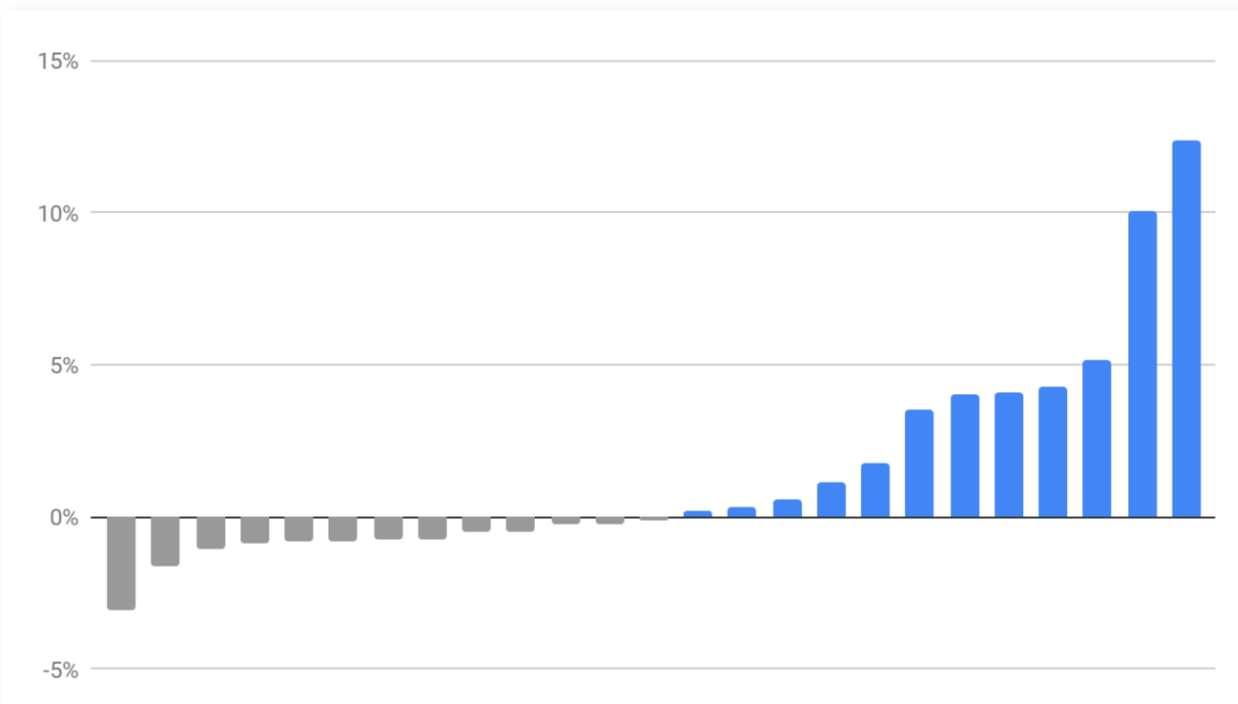
Our sector tilts over the past couple of years also have had a cyclical element to them. Our core skill set is business analysis, not making macro calls, but we do not keep our heads in the sand when it comes to the broader economy. To that end, we continue to lean further into our general bias towards businesses with global footprints and recurring revenue business models given the confluence of a slackening economy and fragile domestic balance sheets.

Some specific concerns jump out, such as the Federal Chamber of Automotive Industries reporting that new vehicle sales are down 8.4% this year on a soft 2018, but we're more concerned about the broader measures including that credit growth is decelerating and that household savings rates are at the lowest levels since prior to the GFC, according to the RBA. Also, on the balance sheet side, we note that Australian residential property prices are down around 8% from their peak, which is uncomfortable given that household debt relative to annual household disposable income is hovering around 1.9 times today compared to around 1.6 in the GFC era and 0.7 at the time of the early 90's recession.

We are long-term optimists, however, it would be naive of us to not acknowledge the confluence of a softening economy and personal balance sheets which are far more levered and rigid compared to the last time Australia experienced a recession. To that end, while the Fund's cash position, which sits at 10.9%, or 13.1% net of reinvested final distributions, hovered around 12% to 16% during the year. Running with a good-sized cash allocation has cost the Fund some performance, however, we take significant comfort in our ability to deploy large licks of capital should a recession finally rear its head.

But enough with all that macro and sector talk. Let's get back to our favourite subject: Stocks. The Fund's largest holdings to finish the year, which made up 38.9% of the portfolio, were **Afterpay Touch, Nanosonics, EML, Audinate, and Pro Medicus.** Each should look familiar to investors as we've discussed them in investor letters.

Turning to performance, the Fund had a modestly lower strike rate in terms of positive contributors during the year compared to the benchmark -- 48% vs. 53% -- but the Fund hit with significantly more power when it did connect thanks to its growth orientation. The Fund's top quintile of performers contributed roughly 4.9 times as much as its worst quintile detracted compared to a multiple of only about 1.5 times for the benchmark. In other words, when we were right, we were very right.



The biggest contributor to performance was Afterpay Touch, whose shares increased by 168% during the year. The business had a big year as it continued to grow at hearty rates in Australia and New Zealand, reach above 1 million users in the US, launched into the UK, and expanded its addressable markets via successful traction in physical stores and into new verticals.

Afterpay joined the S&P/ASX 100 in June of this year. In accordance with our mandate, the Fund is able to hold stocks that grow into the S&P/ASX 100 as letting winners run is core to our philosophy, however, we cannot purchase additional shares from that point. Some of the market capitalisation growth was due to a $137 million capital raising in August and a further $317 million raise in June. The Fund did not participate in either institutional placement and was a net seller throughout the year.

Underlying sales increased by 143% in the 11 months through May on the prior comparable period. Afterpay now has over 4.3 million active customers and, during the first five months of the calendar year, added approximately 7,900 new customers per day. For context, in the fourth quarter of fiscal 2018, Afterpay added about 3,600 new users a day. Pleasingly, despite the acceleration in new user growth and expansion into new markets, net transaction margins were stable in the first five months of the second half relative to the whole of the first half, suggesting the economics of the more mature regions (namely Australia) are improving rapidly as the user base seasons.

The US rollout is also going great guns. Afterpay had more than 1.5 million users as of the end of May and reached a A$1.7 billion annualised underlying sales run rate after just 13 months of operation, a milestone that took around three years to achieve in the Australian market. While true that transaction-level economics in the U.S. aren't likely to be as strong as they are in other countries because the market has structurally higher payment processing costs, the fact that total U.S. retail sales are more than 23 times that of Australia still leaves plenty of headroom.

On top of new markets, channels, and verticals, Afterpay has call options around new products for both merchants and consumers. For example, it isn't hard to picture Afterpay creating an ad business at some point given that Afterpay is now already the second-largest traffic driver behind Google in Australia. We also think Afterpay could leverage its strong brand equity to follow the lead of U.S. rival Affirm by offering savings accounts to its users, around 85% of whom plug debit cards into their Afterpay accounts. Afterpay could also shave off processing costs by encouraging its users to skip cards entirely and plugging Afterpay directly into their bank accounts.

Many investors are skeptical of how Afterpay would navigate an Australian recession, which is a valid concern considering the business model has not been tested across an economic cycle. The business is no longer a purely Australian story, though, and grows more global by the day. For that matter, because the payback periods on Afterpay purchases are so short, the company can quickly adapt to a softening environment by tightening its standards, simultaneously reducing default rates and gross leverage. On that note, we expect Afterpay's funding costs to fall as the business model matures, the user base grows and seasons, and the company's reliance on any single geography fades.

It has not all been smooth sailing, though. Like almost every popular disruptive business, Afterpay has caught the attention of politicians and regulators as it navigates frameworks that pre-date its existence. We have little doubt that Afterpay will continue to face questions on its model in all the markets in which it operates, likely having to incrementally adapt its model as it goes along by increasing checks on both consumers and merchants. We also would not be surprised if the current AUSTRAC-inspired audit and review of Afterpay's anti-money laundering and counter-terrorism financing review processes led to a fine, though the business is well capitalised following its latest capital raise.

All in all, Afterpay Touch remains a business with a wide range of outcomes. We see many ways to win but also recognise that the credit model has not yet been stress tested and that the business will remain closely watched by politicians and regulators here and abroad. We're comfy with the risks given the potential, though, and continue to hold a large position despite having taken significant profits.

The second largest contributor was Pro Medicus, whose shares increased by 218% as the thesis became better and more widely understood by the market. The share price has become demanding, thus we've taken some profits, but the business has provided us plenty of reasons to stay patient including its sticky and highly regarded customer base, high and rising margins, growing pipeline, debt-free balance sheet, high insider ownership, and diverse geographic footprint.

Pro Medicus business highlights during the year included signing its largest deal ever, a seven-year, $27 million contract with Partners Healthcare, plus leading teaching hospital system Duke Health. While the focus remains on winning the North American viewing market, the company also made further headway in Europe by securing an expanded agreement with a German government hospital network. With reports that Visage implementations take only 10% to 25% of the time it takes competing products and that most customers realise a 20% productivity improvement after moving to Visage, it's little wonder large hospital wins continued.

The company has also long raised the prospect of applying their image-viewing technology to other *'ologies'*, and the launch of a new product in cardiology and ophthalmology is imminent, which could materially expand Pro Medicus' total addressable market. The company's strong track record of completing large implementations ahead of schedule positions it well to enter these new markets, and expand existing relationships, potentially without having to go through the same drawn-out tender processes as when it built a foothold initially. We remain enthused about the future of the business, but also increasingly watchful of the expectations implied by the share price.

The third largest contributor was Audinate, which increased by 114% from when the Fund initiated its position in September. Audinate's 'Dante' platform continues to expand as the global industry standard for the professional audio-visual (AV) market and is used in over 5 times the number of audio products to the nearest competitor. The gap is widening as original equipment manufacturers (OEMs) are now able to rally around a leading standard and we estimate that around 99% of new networked audio products are running with the Dante platform.

Historically the company's focus was on the audio segment of the AV market, but in January the company released their digital video offering on the Dante network, roughly doubling their addressable market and paving the way to further boost revenue from FY20. Success in video is by no means certain but Dante's strong brand and the existing distribution channels should make for a running start.

A further expansion of the addressable market was announced in June with the release of additional software-focused offerings allowing manufacturers to add full Dante functionality into processors, as well as allowing developers to seamlessly integrate Dante functionality directly into PC and Mac applications. This software based implementation enables Dante functionality into existing products without a major redesign by OEMs and should drive growth in the number of networked Dante endpoints.

Owning the dominant AV platform while still in the early stages of a large-scale market shift exemplifies the type of long-term opportunities we seek. We are pleased with how this investment thesis is playing out and arguably strengthening as Audinate removes friction to Dante integration.

That's the good stuff. Not all went to plan in 2019, though. We gave too much rope to some investments where our thesis drifted and have since tightened up our tolerance. It's one thing if a quality business hits a soft patch but it's another if the thesis has vectored off in another direction.

The most significant detractor to performance was **BWX**, whose shares decreased by 70.9% from the start of the year until we exited in May 2019. The year started with the company in the midst of navigating a proposed buyout by previous management and Bain Capital -- in May 2018 -- at which time we sold around a third of the Fund's stake. In hindsight, we regret not unloading more of our position at that time given that our thesis had already drifted a good deal since our original investment.

The company went on to deliver underwhelming full-year results and the proposed bid ultimately fell over in September. We thought the failed bid and formal resignation of the former CEO and CFO marked the end of a period of distraction and uncertainty for the company, and provided much needed clear air for new management at what appeared a reasonable price, so we retained the balance of our position. Unfortunately, that did not play out as expected.

BWX downgraded its profit estimates by 27% in December, just two months after its prior trading update, which in itself was a downgrade, and the stock price nearly halved in response. It looked more and more as if previous management had pushed very hard to get a lot of stock into channels as well as acquiring three businesses in as many months to beef up sales and earnings. Notably, we declined to participate in the capital raises to fund those acquisitions.

There was still more to come. BWX announced in May what was its third downgrade to FY19 earnings in under six months, and the sitting CEO left the business to be replaced by a third CEO in under a year. BWX is now far into turnaround territory and the current thesis looks nothing like our original one, or of the type that we seek out in new opportunities. As such, we exited the balance of our remaining small position and learned a lesson in being quicker to acknowledge when a once-promising thesis has drifted.

The second most significant detractor was **Class**, whose shares fell by 35.9% during the year. We are kicking ourselves for not having been more concerned about the significant increase in Class' customer acquisition costs as the incumbent competitor got its act together. Another big influence to Class' slowing growth was that the growth of the core SMSF market slowed meaningfully. According to a recent Vanguard/Investment Trends report, SMSF establishments halved from a peak of 43,000 in the final quarter of 2012 to 20,000 in the first quarter of 2019.

The slowdown in the core SMSF market led the business to change tack: broadening its focus and changing CEOs in February. The outcome is an increased focus on the faster growing non-super portfolio service and a stronger push into the financial advisory market, including the acquisition of a managed discretionary account service provider, as Class tries to rediscover its growth mojo.

Increasing integrations continue to improve the value-add for clients and it has manifested in Class being recognised as #1 highest overall client satisfaction in the Investment Trends Awards for the 5th straight year, resulting in their 99% customer retention rate. Combined with a strong balance sheet -- net cash makes up around 11% of the market capitalisation today -- and a valuation that has had the air come out and we've decided to stay around a while longer to see how things unfold.

The third most significant detractor was **Citadel Group**, whose shares fell by 28.6% during the year. It's been a rough 12 months at Citadel. The company fell short of market expectations at the half year and the resignation of one of the company's founders shortly before the results did little to calm investors.

Those tumults were followed by a full-year profit downgrade in May due to a combination of project delays, lower customer spend leading into the May federal election, and the ongoing transition to more software-as-a-service (SaaS) based revenue. Given its base of government clients, elections are an unhelpful time for Citadel as government departments slide into 'caretaker mode' and project progress comes to a standstill.

While the May downgrade was a steep miss in terms of short-term expectations, our long-term thesis remains unchanged. We remain enthused by Citadel's SaaS revenue being the fastest growing portion of the business with a long runway from its current one-third revenue contribution. The mix shift to SaaS will be bumpy -- it pushed gross margins down 2.9 percentage points to 47.3% at the half year -- but we expect that trend will turn as the SaaS customer base seasons and the high implementation and customer onboarding costs are lapped.

With SaaS accounting for roughly two-thirds of Citadel's pipeline, it is easy to picture increasing gross 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 Citadel's long-term prospects.

Our low turnover also speaks to our selective nature, which also shines through when evaluating deal flow. The fund has been pitched a combined total of 225 IPOs, pre-IPOs, and institutional placements, however, it has only participated in seven. Put another way, we've declined around 97% of the deals we've been presented. While a small sample size, we think we've selected well thus far given a cumulative total return of about 115% on the dollars we've invested in those deals.

Thank You

On behalf of all of us at Lakehouse Capital, thank you for your continued trust. It means a great deal to us and we are incredibly fortunate and grateful to have such a strong, diverse, and aligned foundation of investors. We can't promise that the next couple of years will look like the past couple but, regardless, we'll stick to our playbook and keep doing our best for you.

Best Regards,

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

Data source: **Lakehouse Small Companies Fund https://www.morningstar.com.au/Funds/FundReport/41682*