Dear Lakehouse Investor,

Companies Held:	19
Cash Allocation:	14.4%
Top 5 Portfolio Holdings:	40.0%
Net Asset Value per Unit (mid):	$1.6927
Fund Net Asset Value:	$240.0 million
Benchmark:	S&P/ASX Small Ordinaries Accumulation Index

February was a tumultuous month as investors panicked in response to the rapid spread of the coronavirus disease now known as COVID-19. The drama really kicked into high gear in the last week of the month with the ASX posting its worst week since the GFC. Meanwhile, Australian companies reported earnings in the backdrop of all this, and our team hustled to talk shop with current and potential portfolio companies on 22 occasions.

The Fund had a particularly bad month given the broader market's fall and that shares of higher-growth companies on the ASX took the drop especially hard. It also didn't help that the Fund's portfolio companies, while collectively delivering strong, thesis-affirming results that leave us feeling very good about their long-term prospects, had mixed success in meeting the market's expectations. We'll speak to results from our key holdings and conviction behind them in a moment.

All up, the Fund returned -12.3% net of fees and expenses during the month compared to a -8.7% return for the benchmark. Over the past 12 months the Fund has returned 17.0% compared to 1.6% for its benchmark. And, since inception in mid-November 2016, the Fund has produced a net total return of 85.3% compared to 30.8% for the benchmark. In annualised terms, the Fund has returned 20.6% per year since inception compared to 8.5% per year for the benchmark.

The month was a good reminder of the virtue of a long-time horizon. The Fund has lost money in 13 of the 40 months in which it has operated and, yet, has delivered a total return more than double that of its benchmark since inception. Over the span of a single month, it is broader market moves and short-term company news that shape the Fund's returns. Over the measure of years, though, the performance of the Fund gravitates towards the fundamental performance of its portfolio companies.

Our view on COVID-19 is a balanced one. On the one hand, the virus is blowing past containment efforts, as we predicted a week ago, creating a genuine public health crisis and introducing short-term risks around demand and supply chains that investors would do well to observe. Indeed, the number of countries with confirmed cases has swelled from 41 to 68 since our article was published less than a week ago, only increasing our conviction that the mounting risks must be taken seriously.

On the other hand, we are long-term optimists -- a mindset that has served patient investors well more often than not. For that matter, we also should not overlook that Australian small-caps have fallen 11.6% from their highs, that the yield on Australian 10-year government bonds has plunged to 0.7%, and that a tidal wave of fiscal and monetary stimulus is likely on the way.

Our ongoing strategy right now is to reduce exposure to companies that have outsized exposure to demand, operational, or supply risks caused by a probable broad-based outbreak and containment initiatives. Conversely, we have been actively increasing our holdings in companies with strong balance sheets, highly loyal customers, digital-first business models, and those with network dynamics where adoption curves might be pulled forward from changes that might result in how we all live, work, and play. In other words, we are leaning even harder than usual into our preferred style of companies. We are also putting increased emphasis on liquidity and the Fund's cash position remains conservatively positioned at 14.4%.

Now let's talk about stocks. It was an up and down reporting season for the Fund with the market being particularly unforgiving. For example, **Catapult** reported 18% revenue growth in year-on-year terms with operating expenses falling 4% -- a rare feat and likely to put the company free cash flow positive this year, which is ahead of schedule -- and yet the shares fell 19.4% over the three trading days following the release. Tough crowd.

An ordinary reporting season aside, we remain very pleased with the calibre and long-term prospects of the companies we own. The Fund's portfolio companies collectively grew revenue by 37% during calendar 2019 compared to just 4% for the 'small companies' benchmark. We also estimate that around 77% of the Fund's invested capital is backing companies with explicit recurring-revenue-centric business models, which gives us great comfort.

Zooming out to the sector level should help provide further context on how different our strategy is to the broader market for smaller companies. The Fund's largest sector allocations are to information technology (62.6% of total capital), health care (11.2%), and financials (8.7%) while the benchmark's largest allocations are to materials (21.1%), real estate (14.2%), and consumer discretionary (13.6%). We're happy to have a 0% allocation to materials, not only because the industry is historically a money pit but also because of the steep drop off in manufacturing activity in the world's incremental buyer of materials, China.

Company News

Turning to specific companies, the Fund's most significant contributor to performance during the month was the Fund's new stake in investment and superannuation platform **Hub24** (-7.3%) which we will discuss in more detail next month. The biggest detractor during the month was **EML Payments** (-31.2%), which delivered a strong result but failed to wow investors with what struck us as conservative guidance.

The Fund's five largest holdings as of the end of the month accounted for 40.0% of the portfolio and are named in order of the Fund's allocation: **Afterpay**, **Nanosonics**, EML Payments, **Nearmap**, and **Bravura Solutions**. Here is a rundown on what happened with their latest results.

Afterpay reported another in a long string of impressive results. Active user growth accelerated to 134% year-on-year as the business continues to grow into larger markets, namely the US and UK. The company disappointed on the bottom line but this was largely attributable to an acceleration in marketing spend to support onboarding new merchants who bring large, lucrative customer bases with them. We think this spend is wise given the opportunity is growing, the self-reinforcing dynamics of Afterpay's network effect, and that the company is able to make progressively smarter marketing spend decisions thanks to the insights gleaned from its growing base of merchants (43,200) and active users (7.3 million).

A strongly thesis-affirming note was that gross loss rates fell from 1.2% to 1.0% over the past year despite the high rate of growth into new markets (where Afterpay has less insight into how to assess risk) and an increased proportion of active users being new (new users are the most likely to not pay Afterpay back). We were also pleased to hear that the company will soon push into Canada and that an in-store offering, which now makes up 24% of underlying sales in Australia and New Zealand, will be launched in the US later this year.

Afterpay has never been conventionally cheap and we've always been quick to acknowledge its shares have a wide range of outcomes. Still, for all the talk about its valuation, we note that the key driver behind the shares' success over the almost three years we have been invested has less to do with valuation and more that the company has grown its active users by roughly 20-fold. Regardless, though we remain confident that the range of outcomes skews favourably to long-term holders, we continue to closely monitor the business and its dynamics with all its competitors and stakeholders.

Nanosonics also delivered another pleasing result. The fundamentals for adoption of their high-level disinfection devices continue to improve and the business continues to progress its global expansion in existing and new markets. The key metric -- installed base of devices -- grew 17% and revenue growth was a tick higher at 19% helped by a 40% jump in consumables revenue. Long-time Lakehouse investors will be familiar with Nanosonics' razor-and-blade-esque model. The high-margin recurring-revenue from consumables now represents over 70% of the total, up from just under 60% a year earlier. High levels of consumables revenue will continue to drive the profitability of the business as the installed base grows.

Nanosonics remains well positioned to capitalise on its large market opportunity with high levels of recurring revenue, a diverse customer base, fortress balance sheet, continuing R&D investment toward future growth, and the potential for increased awareness of the importance of disinfection stemming from the ongoing public health crisis. The company remains tight-lipped on details of a new product in the works but they expect commercialisation in FY21 -- subject to regulatory approval -- and a similarly sized addressable market to the current Trophon devices.

EML Payments posted a great result with gross debit volume (GDV) and EBITDA growing at 60% and 42%, respectively. The company posted these figures despite a rare customer loss and weakness in the UK and German markets, which showcases the diversification of EML's portfolio across clients and geographies. Meanwhile, the company continues to win new clients, expand in existing ones, and create new use cases. For this half, EML launched gift card programs in 150 malls with the largest mall operator in the US, Simon Property, and launched new programs in the UAE and Italy. The VANS segment continues its strong growth as well, focusing on bill payments aggregators like Viewpost and BillGo, and new use cases continue to be developed such as lottery payouts in the US.

Some investors were disappointed by the delay in the regulatory approval for the acquisition of Prepaid Financial Services (PFS). We see this delay more as a function of timing rather than risk of not gaining approval, which may drift for months but not years. We invest with a much longer time horizon, though, appreciating EML's journey from an Australian gift card provider with one client when Tom Cregan first joined the company to what it is today. We're excited, as the PFS acquisition does not only diversify the company into new and higher quality revenue streams, it also secures an E-money License with UK's FCA creating further growth opportunities. We remain patient investors, understanding the opportunities ahead, management's alignment and ability to execute.

Nearmap's disappointing downgrade to full year guidance in late January left little room for surprise in the company's half year results. Annualised contract value of subscriptions grew 23% to $96.6 million, a material slow down from the 36% growth delivered in fiscal 2019. Meanwhile the proportion of multi-year deals increased to 42% from 36% a year earlier providing improved visibility over future revenue.

Despite the recent stumble, Nearmap's business fundamentals remain attractive. The company is applying a very data-driven approach to a large addressable market, actively enhancing the product with more and fresher content, as well as additional features and tools. The addition of 3D imagery, artificial intelligence and roof geometry should help to establish new use cases and drive average revenue per subscription higher across the business.

Digging deeper into historical churn rates and the specifics of recent customer losses reinforced our view towards the half being an outlier. Nearmap's fundamentals, increased mix of recurring revenue and management's more conservative approach to revised full-year guidance gave us the confidence to top up. We continue to like the business' prospects and expect the $49.3 million net cash balance will see it through to breakeven.

Enterprise software provider Bravura handed down a satisfying half-year report with net profit growing 11%, or 21% including a one-off tax credit. Earnings per share growth appeared more muted at 7%, skewed by the 13.3% share count expansion as the company raised $165 million at $5.75 per share in May 2019 prior to Lakehouse investing. A particular bright spot in the results was recurring revenue expanding to 78% of total revenue compared to 71% in the prior corresponding period. This trend demonstrates that the lifetime value of Bravura's customers is increasing faster than headline revenue growth suggests.

Bravura's enterprise customer wins tend to be lumpy and can present significant 'risk' half-to-half for shorter-term investors. While there's some market concern around a couple of large wins baked into the current full year 'mid-teens NPAT growth' guidance, we remain attracted to the underlying structural growth, Sonata's product leadership and modern code base, the sticky customer base, and overcapitalised balance sheet with more than $100 million in net cash.

Looking Ahead

Lakehouse continues to closely monitor the rapidly evolving COVID-19 situation, in particular the economic impacts that may unfold and how they will impact current and potential investments. The Fund's cash holding is at the higher end of the typical range, allowing us to play offense and remain on the hunt for compelling opportunities to deploy our investors capital during this bout of volatility.

Thanks again to all our investors for your time and trust. It's an honour and a privilege to serve such an aligned, long-view group.

Best Regards,
Lakehouse Capital

by law, to resupplying this information or any part of it to you, or to paying for the resupply of this information or any part of it to you.