LAKEHOUSE CAPITAL
A Motley Fool Company

LAKEHOUSE GLOBAL GROWTH FUND
MONTHLY LETTER
31 March 2020

Companies Held:	19
Cash Allocation:	6.8%
Top 10 Portfolio Holdings:	66.9%
Net Asset Value per Unit (mid):	$1.4258
Fund Net Asset Value:	$143.5 million
Benchmark:	MSCI All Country World Index Net Total Returns (AUD)

Dear Lakehouse Investor,

March was a wild month in markets featuring a bear and bull market within a single month. The Fund itself was unusually active as we reduced or exited holdings that we think have outsized risk to the unfolding economic shock while increasing and initiating others that we think are more resilient than the market appreciates. We'll talk investors through the positions we opened and exited later in the letter plus discuss how we view the Fund's largest holdings through the prism of the current environment.

The Fund returned -2.4% net of fees and expenses for the month compared to -8.9% for its benchmark. Over the past 12 months the Fund has returned 17.1% compared to 3.0% for its benchmark. Since inception at the start of December 2017, the Fund has returned 44.3% compared to 13.7% for its benchmark. In annualised terms, the Fund has returned 17.0% since inception compared to 5.6% for its benchmark.

A weak Australian dollar contributed to absolute Fund performance; however, the benchmark is also priced in Australian dollars and thus the relative outperformance of the Fund is mostly unaided by swings in the Aussie battler. In English, the Fund has performed relatively strongly even with the currency boost taken away. More broadly, we remain pleased with the Fund's performance since inception and, as ever, remain focused on long-term results.

Investment Strategy in a COVID-19 World

We told investors last month that our view on the situation surrounding COVID-19 is a balanced one. That largely remains the case today and the Fund still has dry powder but, with major indices down around 35% at points during the month, we grew decidedly more opportunistic and the Fund was a net buyer.

On the one hand, the virus blew past early containment efforts and created an economic shock and public health crisis that has not been rivalled in our lifetimes. Sadly, most governments were half-hearted in their initial approach to containing the virus while some are still not taking it seriously enough.

On the other hand, there are plenty of reasons for long-term optimism, the most fundamental of which is that patient investors have historically outperformed speculators who dart in and out of the market. Beyond that, we've observed the following:

- Social distancing and containment efforts have been embraced in most developed countries and we've already seen inflection points on new confirmed cases in China, South Korea, Italy, Spain, and the state of California, which is the world's fifth largest economy.
- Effective, low-cost means of reducing the spread including temperature checks, wearing masks, and washing hands with soap are becoming more widely adopted.
- Existing medical supply companies as well as non-traditional contributors such as automakers are rapidly scaling the production of badly needed medical supplies including masks and ventilators. The supply of tests is also quickly rising and new ones on the way will provide results in minutes, not days.
- The medical community is learning more about the virus as we go and the World Health Organization is now trialling four different drug treatments for COVID-19.
- Money is close to free with interest rates at or near their all-time lows in most markets.
- The gross leverage of the world's 50 largest banks by total assets is 32% lower today than it was when the world was heading into a crisis in 2007, per data we've crunched from S&P Capital IQ. This suggests the financial system is far better placed to handle a shock than previously.
- Governments and central banks the world over are unleashing wave after wave of fiscal and monetary stimulus that is unprecedented in its speed, scale, and scope, best embodied by the nickname of the Federal Reserve's newest program: QEinfinity.

We want to be clear: we take this virus seriously and expect every facet of this situation to get worse before it gets better. That's why we went into March with a meaningful cash position and started working from home across the business weeks before others were nudged to do so. But here's the rub: the view that things will get worse before they get better has swung from non-consensus six weeks ago to consensus today, as evidenced by most major indices down around a quarter to a third below their February highs despite all of the existing and potential responses we named before.

We will not pretend to know when or where markets will bottom, however, the consensus is already so negative that any hints of an inflection point with COVID-19 or the economy would send share prices higher. What's more, investors who are waiting for the economy to bottom out before buying again will likely have missed the turn in the market. For example, even if you had known for certain that October 2009 would mark the peak of US unemployment and had waited until that turn in the economy to invest, you would have missed a 64% rally from the March lows. Markets look forwards, not backwards.

Two other points before diving into our holdings. First, as long-term investors, whether we pay \$0.60 or \$0.70 for a stock intrinsically worth \$1 today is not of huge consequence to us if that stock is worth \$2 five years from now. Second, we would not underestimate the resolve of governments or central banks to stabilise the economy and pacifcy financial markets. No, showering financial markets with liquidity does not solve the underlying problem, but it goes a long way towards de-risking markets and supporting the prices of financial assets (e.g. shares).

The Fund was a net buyer of shares during the month but in a very focused manner. We reduced or exited companies that have outsized exposure to demand, supply, operational, or financial risks caused by the outbreak and containment initiatives. Conversely, we actively increased the Fund's 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 based on changes in how we all live, work, learn, and play. In other words, we are leaning even harder than usual into our preferred style of companies.

This strategy has led the Fund to be a touch more concentrated than usual in its best ideas, as very few businesses are built to weather such an environment. Supporting that view is research by UBS which, as of 26 March, shows 90% of all Australian companies that have updated the market since this outbreak began have either withdrawn or reduced guidance, with only 7% reaffirming and a lonely 3% upgrading. We're yet to receive formal updates from most holdings on how business is faring but feel good about our positioning given the backdrop.

The Fund's ten largest positions are listed below:

Company	Headquarters	Industry
Facebook	USA	Interactive Media and Services
PayPal	USA	Data Processing and Outsourced Services
Adyen	Netherlands	Data Processing and Outsourced Services
Alphabet	USA	Interactive Media and Services
Amazon	USA	Internet and Direct Marketing Retail
Visa	USA	Data Processing and Outsourced Services
Avalara	USA	Application Software
Constellation Software	Canada	Application Software
M3	Japan	Healthcare Technology
Monster Beverage	USA	Soft Drinks

The Fund's largest sector allocations at month end were to information technology (45.1%), communication services (20.1%) and consumer discretionary (13.5%). The Fund is larger than the benchmark in all three sectors and we expect that will consistently be the case over time as Lakehouse views these sectors, or at least subsets of them, as having superior economics and long-term prospects.

Also, our team does not feel a great compulsion to allocate capital to sectors that are notoriously cyclical, competitive, or capital-hungry, and thus we expect to remain underweight the likes of materials, energy, and utilities. Indeed, our general bias away from these sectors has served us well during this troubled period.

Company News and Thesis Review

We don't normally do thesis reviews in a monthly letter, however, we thought investors would benefit from us briefly reviewing how we view the current environment affecting the outlook for the Fund's largest holdings:

Facebook will face short-term headwinds via a weak advertising market, however, we expect online advertising spend to hold up better than other forms of marketing spend that have fading relevance and unclear returns on investment (e.g. radio, TV, print, billboard). Usage is also spiking in areas where social distancing is now prevalent, which is currently most of the developed world, and while we expect that to cool off it will have brought more users onto Facebook, Instagram, WhatsApp, and Messenger plus better engaged existing users. Facebook is also scoring points with governments right now for partnering on spreading helpful information about the ongoing crisis. Put all that together with US$55 billion in net cash and the least demanding valuation since listing and it is easy to see why we like Facebook's range of outcomes.

PayPal has long gobbled up share of online payments, which itself is gobbling up share of total commerce. The economic slowdown will hurt discretionary spending and cross border trade, however, social distancing is pushing current online shoppers to do more shopping at home, which plays into PayPal's hands, and is also driving consumers who haven't made the jump to shopping online to give it a whirl. It helps that the business is profitable, cashed up, and should be able to play offense during a tough time, plus the shares trade at a discount to historical norms despite the pulling forward of adoption.

Adyen is in many ways similar to PayPal wherein the company earns the majority of its revenues online, has a huge cash pile, and is extremely profitable. We expect revenue growth to slow down due to some exposure in travel but expect some offset from clients which see an increased demand through online channels. More than 80% of the company's growth comes from the expansion of transaction volumes from existing clients, so we don't expect changes to be too drastic. Also, Adyen generates the same revenue on payment volume whether it is made domestically or internationally, so it is shielded from less cross border trade.

Alphabet should experience similar dynamics to Facebook in terms of a weak advertising market but increased usage of some core platforms (e.g. YouTube, Android, and Google Cloud) and increased awareness of others (e.g. Google Classroom and the G Suite cloud productivity suite). Alphabet is also absurdly cashed up with around US$116 billion in net cash, or about 15% of the company's market capitalisation, which could allow for well-timed acquisitions or share repurchases plus the ability to continue to reinvest in the business against the cycle. Meanwhile, the shares are trading for their lowest multiple of forward consensus earnings in three years.

Amazon has held up strongly as social distancing has driven new users to flock to the platform and for existing users to buy more goods, consume more digital media, and presumably upgrade to Amazon Prime at higher rates. In fact, business is booming to the degree that the company announced it is hiring 100,000 new workers in the US to deal with an unprecedented surge in demand. Meanwhile, in the fast-growing and high-margin Amazon Web Services business, while office closures and social distancing has probably tripped up deals that were close to closing, we expect those same trends to drive usage higher and dramatically underscore the value proposition of cloud offerings, pulling the adoption curve forward in the process. Despite those game-changes in demand and the strong relative performance of the shares, Amazon still sells for a modest discount to its recent history in terms of enterprise value relative to forecast gross profit.

It was a wild month and thus there are a lot of moves to discuss as well. The biggest contributor to performance during the month was **M3** (+22.6%), which rebounded after a tough prior month and could see increased adoption and engagement on its platforms because of this crisis. The largest detractor to performance was **MercadoLibre** (-15.8%), which sold off with general market sentiment.

The Fund opened a new position in the month (**Twilio**) and built out a position in a holding initiated in February (**Avalara**). Twilio is a business we've been following for a couple of years but held off on because the price was not right. The founder-led communications-platform-as-a-service (CPaaS) allows developers to embed programmable communications within applications. Simply put, it transforms communications, which is largely hardware and physical networks, into software. If you've ever called your Uber driver through the app or have received a confirmation for an Airbnb booking, you've probably experienced some of Twilio's earlier use cases.

More recently, Twilio moved towards providing higher level services such as Flex, a programmable platform for contact centres, a market which is still 90% on-premise and ripe for disruption. On the Internet of Things space, Twilio has worked to create smart garbage bins to help track the level they are filled. This way, end customers are happy because their garbage is always picked up when they need to be, and collectors save on costs because they are able to optimise their routes daily. These are just some of the use cases and we believe that we've barely scratched the surface when it comes to programmable communications.

Twilio offers a usage-based pricing model and is embedded within the clients' customer communications workflow, which means Twilio succeeds when the customer succeeds. The company services a large and growing number of active customer accounts (179k) and has reported a stellar base revenue net expansion rate of 136% for 2019, which shows the large opportunity ahead and degree of customer loyalty. We were also pleased to have built our stake at a price around 48% below the shares' highs.

Avalara is the leading provider of cloud-based solutions that automate the calculation and filing of sales and use tax. This is an extremely complicated and burdensome process for any business to handle manually, especially for online or multi-location retailers. In the United States alone, there are currently over 12,000 different sales tax jurisdictions, each with their own unique rules and regulations that continue to evolve overtime. To this end, Avalara's value proposition is fairly straightforward -- their cloud-based platform eliminates considerable time, cost, and risk inherent with the manual approach to complying with sales tax -- and is reflected by the company's impressive 111% net revenue retention rate.

Avalara has a commanding lead in the market -- 50% share -- and is likely to keep it given the company has spent 14 years building and maintaining a library of tax content and has developed an ecosystem of over 750 partners that refer a significant portion of its business. There is also still a long growth runway ahead with Avalara estimating the growing market is only 10% penetrated. We built the Fund's stake at an average price around 24% below the shares' high, which we think is an attractive jumping off point given the robustness of the business and ability to reinvest at attractive rates for many years to come.

The Fund also exited four companies during the month: **Booking**, **Nestle**, **FeverTree**, and **Paycom**. All are fine businesses, however, the current game-changing environment led us to reallocate from these companies to others that we expect will prove medium- to long-term beneficiaries of the current crisis. We'll discuss the decisions to sell each below in descending order of the Fund's cost basis.

We initially cut our stake in Booking Holdings in late January as we became concerned of the escalating downside risks despite the share price being relatively flat. In early March, we completely exited our position due to further evidence of this current scenario worsening while estimates were still reflecting a fairly positive outcome. Booking withdrew its then 12-day-old guidance only hours after we exited. The Fund realised a 3.4% capital gain on the position in Australian dollar terms.

We made the decision to exit our position in FeverTree when it became clear that social distancing measures, particularly limits on public gatherings and the closure of FeverTree's key on-trade business (e.g. pubs, clubs, etc.), would sweep across the UK and US. FeverTree derives roughly 40% of its sales from the on-trade and this struck us as an outsized short-term risk. Further, while premium tonic water has been rising in popularity, there is potential that consumption habits and preferences could be altered by the current crisis. For us, the range of possible outcomes had simply become too wide, and as such, we felt it was prudent to cut our losses and move on. The Fund realised a 54.8% capital loss on the position in Australian dollar terms.

Paycom has long been one of our favoured names in the SaaS space and there is little doubt it is a high-quality business. That being said, we made the decision to exit our position due to an expected spike in US unemployment, a challenged SMB market, the complications social distancing would introduce to the company's high-touch sales model, reduced interest rate expectations, and a relatively demanding valuation that was above its historical norms. The Fund had previously reduced the position around the middle of last year on valuation concerns and, all in, realised a 188.9% capital gain on the position in Australian dollar terms.

Our position in Nestlé served us well as perhaps the more conservative position within the portfolio. As the broader markets declined significantly over March, Nestlé outperformed on the way down as we would have hoped. With many other stocks off much more, we felt there were better opportunities to rotate out of Nestle and re-allocate the capital to other opportunities that had become much more attractive on a risk-reward basis. The Fund realised a 50.7% capital gain on the position in Australian dollar terms.

Introducing New Team Members

We've mentioned in the past that Lakehouse has been reinvesting in itself over the past year including making our business more robust with the hires of two experienced operations professionals and upgrading our order management, portfolio accounting, investment data, and portfolio analytics systems. We've also moved to a larger office to support our growth.

Lakehouse has also made a significant commitment to its clients and the market by growing its distribution and client service team from one to four members in the past year. To that end, we are excited to announce that Stuart James has joined Lakehouse as its Head of Distribution. Stuart was most recently with Aberdeen Standard, one of the world's largest investment managers, for 23 years where he served as Head of Distribution among other roles during that time. We're thrilled to have someone of Stuart's caliber join the team in such a key role.

We are also happy to announce that Edwina Best has joined the team as a Senior Business Development Manager. Edwina is well known and highly regarded in the community, having run her own firm, Gateway Financial Marketing, for the past 17 years following working at Macquarie.

Stuart and Edwina have dived right into the business and are working closely with our existing team members, Mark Fenech and Connor McGrath, who were already doing excellent work. We're pleased to not only be in a position to better serve existing clients but also to get out and engage with the broader investment community.

On a related note, Lakehouse Capital has also made a long-planned change to its board of directors. Bruce Jackson will be stepping back from his role on the board after more than three years to focus more of his time on his primary role as the General Manager of The Motley Fool Australia. Bruce has been an unwavering advocate for Lakehouse since it was nothing more than an idea and our team will be forever grateful for his support.

Bruce also wishes us to pass on that he and his wife remain as investors in both Lakehouse funds. To date, they have never redeemed any of their Lakehouse holdings, and currently have no plans to do so for the foreseeable future. On the contrary, they have regularly added to their Lakehouse holdings, including significantly so during March 2020.

Lakehouse co-founder and Chief Investment Officer Joe Magyer will be stepping onto the board as Bruce's natural successor. Suffice to say that he knows the business well and we do not expect to miss a beat.

Ah, and one last point of business: In an effort to adapt to the current environment, the Fund is now accepting scanned and faxed applications and redemptions where they meet certain requirements during this COVID-19 period. Investors should read the notice posted on 20 March

2020 for details. Meanwhile, investors and advisers are still free to top-up their holdings simply by making a BPAY transfer with no further action required. More details are available here.

Thank You

Thanks again to all our investors for your time and trust. We can't promise performance or tell you exactly when markets will turn, however, we can promise that we will continue to hustle and stay true to our long-term, high-conviction approach.

Best Regards,
Lakehouse Capital